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S. Hrg. 99-502

OVERSIGHT OF THE STAGGERS RAIL ACT OF 1980

#146

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
SURFACE TRANSPORTATION

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

OVERSIGHT OF THE STAGGERS RAIL ACT OF 1980

NOVEMBER 1 AND 4, 1985

Printed for the use of the
Committee on Commerce, Science, and Transportation

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OVERSIGHT OF STAGGERS RAIL ACT OF 1980

FRIDAY, NOVEMBER 1, 1985

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:15 a.m., in room SR-253, Russell Senate Office Building, Hon. Bob Packwood (chairman of the subcommittee) presiding.

Staff members assigned to these hearings: Pamela Garvie, staff counsel, and Linda Morgan, minority staff counsel.

OPENING STATEMENT BY SENATOR PACKWOOD

Senator PACKWOOD. The committee will come to order, please.

We are having this morning the first of two oversight hearings on the Staggers Act. Needless to say, we have had some—not many—but some complaints about some of the actions of the railways under the act, and I emphasize "not many." There have been some allegations of egregious rate increases and some allegations of unfair discrimination.

In my experience in investigating many of them, I found that much of the frustration comes from a lack of information. One shipper does not know what another shipper is paying and therefore imagines that the other shipper has an infinitely better rate than actually exists.

I have discovered that some shippers have learned how to negotiate with the railroads in terms of contracts, and that there have been fewer complaints than there were before. On the other hand, I have to say that there have been more complaints about rail deregulation than about truck deregulation—where I have had almost no complaints from shippers—and airline deregulation where, except for the towns that literally have lost service, there have been relatively few complaints from the bulk of the flying public.

So this will be the first of two hearings. I hope that we can lay at rest some of the frustrations that both parties have felt, if they will reveal themselves fully in these hearings today.

I might indicate that I may have to excuse myself temporarily, and I will ask Senator Pressler to take over. We are involved in the debt ceiling Gramm-Rudman proposal. Those are going on the floor at 11 o'clock in the House today. Neither the Democrat proposal nor the Republican proposal are fully ready yet. The Members are going to vote on them in about 3 hours, and a cropper has come up on the Republican proposal that I may have to go over and settle. I am expecting a call and will know momentarily.

Senator Pressler.

Senator PRESSLER. Mr. Chairman, I would like to make my opening statement a little later. I am going to rework one paragraph of it here.

Senator PACKWOOD. That is the same thing we are doing with the bill over on the House floor.

Senator Long.

OPENING STATEMENT BY SENATOR LONG

Senator LONG. Mr. Chairman, I am a cosponsor, along with Senator Andrews and others, of legislation to make the Staggers Act work the way that we intended it to work when I voted for it, and I believe the way that the Congress intended for it to work—certainly the way the Senate intended for it to work.

There are amendments being incorporated in the legislation that will help to clarify and make more practical this legislation, which you will find has a substantial amount of support. The proposed legislation is not reregulation. The basic deregulatory thrust of the Staggers Act will be preserved. The bill does not propose to regulate any traffic that is not now regulated under the act.

The bill accepts the basic parameters of the Staggers Act. It seeks to deal with abuses that were anticipated in other regulated industries and by shippers during the legislative process and at the time the Staggers Act became law, and, I regret to say, fears that have been realized.

Now, there is something inherently wrong in the ICC's determination of revenue adequacy when it holds that all class I railroads are revenue-inadequate, including Norfolk Southern, which is offering $1.2 billion to purchase Conrail, and which the Secretary of Transportation is pointing to as an outstanding example of a very successful railroad.

The ICC has adopted rate reasonableness standards, including stand-alone cost, which make it virtually impossible for a coal shipper to win a rate challenge. In fact, in spite of the many challenges that have been made by shippers, the ICC has never held in favor of a shipper in an overall rate challenge case using Staggers Act standards.

The ICC has shown little if any inclination to take corrective action on its own. Hence, the need for legislation that I have joined in proposing, together with Senator Andrews and other Senators. Similar legislation, I understand, has been sponsored in the House of Representatives.

So we believe we have a real problem, and we appreciate the hearing and will appreciate this committee's attention to the problem.

Senator Hollings has a statement for the record and hopes to be here later on.

[The statement follows:]

OPENING STATEMENT BY SENATOR HOLLINGS

The next 2 days of hearings represent another phase in the Committee's ongoing oversight of the Staggers Rail Act of 1980 and its implementation. This Act was in-

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tended to help the rail industry improve its financial health and service by removing unnecessary regulation while at the same time preserving regulatory protection where effective competition does not exist.

As part of its oversight since the passage of this act, the Committee has held two sets of hearings, one in 1981 and one in 1983. At those hearings, the Committee received testimony that the act was working well, increasing the financial stability of the rail industry and enabling it to provide better and more innovative service. At the same time, however, the Committee heard concerns expressed that the ICC was not implementing the act to provide protection where there is no effective competition, as was originally intended.

The oversight hearings which begin today are again intended to bring out information on the progress that has been made in the implementation of the act, with particular attention to the concerns expressed in previous hearings. I look forward to learning about ICC action on resolutions negotiated between the rail industry, concerned shippers, and other parties on such issues as market dominance, competitive access, contract disclosure and boxcar hire regulation—all issues raised at previous hearings.

In reviewing those proposals, it is important to note that the parties involved in these negotiations found it advisable to seek non-legislative approaches to resolving their problems, and that numerous shippers believe that no legislative amendment to the act is necessary or appropriate. However, we need to examine carefully the views of various other shippers and smaller railroads that those negotiated agreements do not go far enough, and that legislation is indeed necessary to ensure that the Act provides the protection that was intended. In this regard, I will carefully review the testimony on the need for S. 477, legislation cosponsored by several of my fellow members and introduced in response to the concerns of electric utility and coal shippers, and others, about the lack of protection for captive shippers.

I supported the Staggers Act when it was passed because I believed that it represented an appropriate balance of the need for a stronger rail network with the need to protect captive shippers. It is clear that the act has resulted in many benefits for the rail industry and shippers. However, I continue to hear concerns about its implementation. Clearly efforts have been made to address them. However, we do need to examine what concerns remain and whether legislative relief is needed to ensure that the act is carried out.

Senator PACKWOOD. Thank you.

Has Congressman Tauzin arrived yet?

[No response.]

Senator PACKWOOD. If not, let's start with Reese Taylor, the Chairman of the Interstate Commerce Commission and we will put on the Congressman after the Chairman testifies.

Mr. Chairman, you are a regular here.

Mr. TAYLOR. I am beginning to feel like it, Mr. Chairman. I see we have your Oregon weather again; another rainy Friday.

Senator PACKWOOD. Well, it makes me feel at home.

STATEMENT OF HON. REESE H. TAYLOR, CHAIRMAN, INTERSTATE COMMERCE COMMISSION, ACCOMPANIED BY ANDREW J. STRENIO, JR., COMMISSIONER; WILLIAM SOUTHARD, DIRECTOR, OFFICE OF TRANSPORTATION ANALYSIS; LOUIS GITOMER, DIRECTOR, RAIL SECTION, OFFICE OF PROCEEDINGS; AND RONALD YOUNG, DIRECTOR, BUREAU OF ACCOUNTS

Mr. TAYLOR. Let me say good morning to the members of the subcommittee. And if I may, I would like to begin by introducing those at the table with me this morning.

On my right is Commissioner Andy Strenio. On his right is Bill Southard, the Director of our Office of Transportation Analysis. On my left is Lou Gitomer, Director of the Rail Section of the Office of Proceedings. And on his left is Ron Young, the Director of the Bureau of Accounts.

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I want to thank you for this opportunity to appear here today to present the views of the Commission concerning the implementation and effects of the Staggers Rail Act of 1980. We have submitted a written statement for the record, and I would like to summarize that statement briefly for you at this time.

To assist in the revitalization and modernization of the rail system, the Staggers Act was intended to encourage competition, provide for the prompt recovery of costs, promote greater rate and service flexibility without Government interference, and emphasize the need for adequate rail revenues.

We believe that the act and its implementation have been generally successful in meeting the congressional goals set forth in the statute.

After 5 years, it is now clear that the Staggers Act has had a positive effect on the railroads' financial condition. Class I railroads reported a substantial improvement in earnings in 1984, due in large part to the recovery in the economy, continuation of the long-term reduction in railroad employment, and the ongoing rationalization in rail plant, equipment, and routing.

Other important factors were the implementation of the Staggers Act rate and cost recovery provisions and the consequent ability of railroads to respond more quickly and efficiently to shippers' needs with innovative rates and improved service levels, thus providing more effective competition among all rail carriers and with truck lines and barges.

Railroad earnings during the first 6 months of 1985 declined compared to the same period of 1984. A slowdown in industrial production has caused the deterioration of the railroad industry's general merchandise traffic. In addition, the strong worldwide position of the dollar has adversely affected export grain, merchandise, and other sales.

Consequently, the Commission's latest earnings report for the class I railroads shows that revenues and earnings for the 12 months ending June 30, 1985, declined in comparison to the same period of 1984.

To combat these trends, the railroad industry has continued to trim expenses. As of August 1985, railroad industry employment totaled 305,326 employees, compared to average employment levels of 324,696 employees for the year 1984, and 480,410 employees for the year 1980.

While the overall rate of return on investment—what we call ROI—is still far below adequate levels, the railroad industry reported an ROI of 5.92 percent in 1984 which in fact was the highest in 40 years.

Certain groups have sponsored research efforts designed to show that the railroads have not merely improved their financial condition relative to their revenue needs, but in fact, are earning monopoly profits. These studies suggest that the railroad industry has amassed a surplus of capital, and that certain railroads have become rich at the expense of the coal shippers who are purportedly being gouged by excessively high rates.

The Commission staff has reviewed these studies and finds that they do not accurately depict the financial condition of the railroads and the earning power of their captive rates. Our staff was unable to verify the data used for these studies, and they are of the opinion that these studies employ assumptions which are inconsistent with the realities of the marketplace.

For example, the staff's review of the Edison Electric Institute's study indicates that the methodology used to develop the returns is flawed because it seriously understates costs. From EEI's brief description of its methodology, it appears that the study defines profitability as any surplus over historical variable costs. This use of variable costs ignores overhead costs which must be covered through differential pricing, and gives an illusion of high profitability.

We would like to conduct a more comprehensive evaluation of EEI's study, but we've been unable to obtain the necessary data that underlies its study.

Copies of the staff analyses of the studies conducted by CURE, CFA, and EEI have been made available at this hearing.

Turning to an important activity encouraged by Staggers, the proliferation of contract rate filings has continued since we last testified. Since passage of the act, over 30,000 rate and service contracts have been filed with the Commission. We now receive about 1,150 new contract filings per month from railroads and shippers of all sizes, covering virtually every commodity.

For example, grain and coal are often thought to be commodities captive to railroads. Yet, a survey of the top grain and coal-hauling railroads indicated that in late 1984, approximately 41 percent of all grain tonnage was moving under contract and some 53 percent of all coal, both domestic and export, was moving under contract.

There has been a significant increase in grain contract activity in 1984 and 1985, with grain and grain product contracts now representing about 25 percent of all contracts filed.

We recognize that certain changes in railroad policy and operations, such as in the area of competitive access, have been unpopular with some groups. Accordingly, the Commission instituted two proceedings to address some of the perceived problems in this area.

By way of background, the Commission instituted a proceeding in Ex parte No. 456, the *Staggers Rail Act of 1980, Conference of Interested Parties,* to gather information from carriers and shippers about the problems and benefits arising from the Staggers Act and to provide a forum for direct discussion between shippers and carriers. We felt that was very important.

Our purpose, in part, was to obtain mutually agreeable proposals for improving the implementation of the Staggers Act. Two of the areas considered in that proceeding were competitive access and market dominance. Although no broad consensus was arrived at in the Ex parte No. 456 proceeding, certain individual agreements were reached by some of the parties in the areas of competitive access and market dominance.

Subsequent to Ex parte No. 456, a rulemaking proceeding was instituted in Ex parte No. 445 (Sub-No. 1), *Intramodal Rail Competition,* to consider the proposed competitive access agreement. The Commission recently voted in open conference on the various issues raised in that proceeding and a written decision was published just yesterday.

Briefly, the rules we adopted include requirements for 45 days notice for all cancellations; negotiations before challenging these cancellations; ICC suspension of cancellations which eliminate effective competition; ICC denial of cancellations which would be anticompetitive; and ICC prescription of through routes, joint rates, or reciprocal switching, if necessary, to prevent an anticompetitive action.

With respect to the issues of proportional rates, we determined that while we have the power and the authority to prescribe these rates, as the parties' agreement did not specifically include a provision for such prescription, we would resolve the question of whether we should prescribe them on a case-by-case basis.

Additionally, in making determinations concerning an investigation or prescription in a competitive access case, the Commission will not consider—not consider--product competition. Further, railroads wishing to rely on geographic competition will have the burden of proving this competition by clear and convincing evidence.

Finally, the Commission decided that its determinations in such proceedings will have no res judicata effect on any litigation arising under the antitrust laws.

A second rulemaking proceeding, Ex parte No. 320 (Sub-No. 3), *Product and Geographic Competition*, was recently voted on by the Commission and that decision was also served yesterday. I would like to summarize the principal issues we addressed therein. The guidelines adopted in Ex parte No. 320 substantially reduce a shipper's burden of showing market dominance by putting the burden of proof on the railroads to demonstrate the existence of effective geographic or product competition.

This is accomplished first by providing that the mere existence of geographic or product competition will not, by itself, establish the existence of effective competition; and second, by placing the burden of proof on the railroads, that receiver or producer alternatives effectively restrain their pricing.

Ex parte No. 320 (Sub-3) also summarizes and clarifies our product and geographic competition guidelines. We have made available to the subcommittee our formal decisions in these two proceedings.

Another very important case recently decided by the Commission is Ex parte No. 347 (Sub-No. 1), *Coal Rate Guidelines*. In our decision served September 3, 1985, we adopted constrained market pricing guidelines for determining the maximum reasonable rate level that railroads may charge for the transportation of captive coal traffic. In adopting the final coal rate guidelines, the Commission made significant changes to the interim guidelines in response to certain concerns raised by shippers.

These changes include: (1) Elimination of the proposed 15 percent limit on the amount that railroads may increase their rates on captive coal traffic in a single year in favor of case-by-case scrutiny of the need for the phasing-in of rate increases; (2) adoption of a long-run marginal cost standard to estimate any avoidable revenue need shortfall; and (3) clarification of the importance of grouping in stand-alone cost presentations.

The guildelines we adopted provide that:

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(1) Captive shippers should not be required to pay more than necessary for the rail carriers involved to earn adequate revenues.

(2) Captive shippers should not bear the cost of any facilities or services from which no benefits are derived.

(3) A captive shipper's responsibility for payment for facilities or services which are beneficially shared by other shippers will be apportioned according to the individual demands of the various shippers, and thus railroads will have an incentive to ensure that competitive traffic contributes as much as possible toward facility or service costs.

(4) Lastly, changes in coal rates should not be so precipitous that they cause severe economic dislocations.

We believe these guidelines will provide the necessary protection for captive shippers and, at the same time, will provide the railroads the opportunity to earn adequate revenues.

Effective competition is the key to the success of the Staggers Act and its implementation. An environment where efficiency, flexibility and adequate revenues are encouraged will promote such competition and the related benefits.

The Commission is implementing the act with this in mind. Where there is a lack of effective competition, the Commission will continue to provide captive shippers protection against unreasonable rates. Meanwhile, by eliminating burdensome regulations and practices which tended to stifle innovative rail management, the Commission is attempting to promote more efficient operations. Innovative ratemaking and marketing have been encouraged and supported. Simplified requirements for constructing and operating new lines and mandatory reciprocal switching agreements, where warranted, will result in stronger intramodal competition, and all of these things, in combination, have resulted in a revitalized rail industry with benefits accruing to both shippers and railroads.

This concludes our summary statement. and unless Commissioner Strenio has some additional remarks, I would be glad to take your questions.

STATEMENT OF HON. REESE H. TAYLOR, JR., CHAIRMAN, INTERSTATE COMMERCE COMMISSION

Mr. Chairman and Members of the Subcommittee: I want to thank you for this opportunity to present the views of the Commission concerning the implementation and effects of the Staggers Rail Act of 1980. In addition to the following statement, we have included:[1] (1) a table giving the status and a brief summary of the Ex Parte proceedings conducted pursuant to the Act; (2) a brief list summarizing all litigation involving the Staggers Act; and (3) a list giving the status of all cases filed under the "savings" provisions of the Staggers Act.

As you know, the Staggers Act substantially reduced Federal regulation of the rail industry, permitting rail carriers the opportunity to obtain adequate earnings while providing adequate protections to shippers that lack effective competitive transportation alternatives. The Act was intended to assist the rail system to remain viable in the private sector of the economy and to allow the railroads to compete more effectively among themselves and with other modes of transportation.[2] To assist in the revitalization and modernization of the rail system, the Stag-

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[1] Appendices I, II, and III, have been retained in the Committee files.

[2] The goals of the Act, as set forth in section 3, are as follows: (1) to assist the railroads of the Nation in rehabilitating the rail system in order to meet the demands of interstate commerce and the national defense; (2) to reform Federal regulatory policy so as to preserve a safe, adequate, economical, efficient, and financially stable rail system; (3) to assist the rail system to

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gers Act encourages competition, provides for the prompt recovery of costs, promotes greater rate and service flexibility without government interference, and emphasizes the need for adequate rail revenues. Both carriers and shippers benefit from the improved service levels and responsive pricing resulting from the ongoing revitalization of the rail industry. And, while there is, in general, greater reliance on the forces of the marketplace, a regulatory process remains to balance the needs of carriers, shippers, and the public where warranted, in the absence of effective competition.

In our view, the Staggers Act and our implementation of it have been generally successful in removing unnecessary regulation, encouraging efficient carriers to earn adequate revenues and to respond quickly to satisfy shippers' changing needs, and balancing the interests of the parties in accordance with the goals of the Act. The ultimate result, we believe, has been and will continue to be a more healthy, competitive, and responsive rail industry.

We now possess more experience in implementing the Act than we had at the time of our last testimony. Through our experience, as well as the passage of time, we are able to ascertain more clearly some of the effects of the Act. Has the Act had a positive effect on the railroads' financial condition? We believe it clearly has had such an effect. For example, despite the magnitude of the past recession, no Class I railroad has filed for bankruptcy since passage to the Staggers Act.

The Class I railroads reported a substantial improvement in earnings in 1984, due in large part to the recovery in the economy, continuation of the long-term reduction in railroad employment, and the ongoing rationalization in rail plant, equipment, and routing. Other important factors were the implementation of the Staggers Act rate and cost recovery provisions, and the consequent ability of railroads to respond more quickly and efficiently to shippers' needs with innovative rates and improved service levels, thus providing more effective competition among all rail carriers and with truck lines and barges. A comparison of operations for the twelve months ending December 31, 1984, with the same period of 1983 shows that:

Operating revenues increased 10.2 percent to $29.2 billion and revenue ton-miles of freight rose 11.5 percent.

Net railway operating income rose $682.5 million or 36.7 percent to $2.5 billion.

Net income before extraordinary items increased $846.2 million or 46.7 percent to almost $2.7 billion.

Rate of return on net investment in transportation property increased to 5.92 percent from 4.39 percent.

Railroad earnings during the first six months of 1985 declined compared to the same period of 1984. A slowdown in industrial production has caused a deterioration of the railroad industry's general merchandise traffic. In addition, the strong worldwide position of the dollar has adversely affected export grain, merchandise and other sales. Consequently, the Commission's latest earnings report for the Class I railroads shows that revenues and earnings for the twelve months ending June 30, 1985, declined in comparison to the same period of 1984. For example:

Operating revenues decreased almost one-half of 1 percent to $28.3 billion. Revenue ton-miles of freight rose only slightly, increasing by about one-half of 1 percent.

Net railway operating income decreased 8.4 percent to $2.2 billion.

Net income before extraordinary items declined 9.9 percent to $2.3 billion.

Rate of return on net investment in transportation property declined to 5 percent from 5.72 percent.

To combat these trends, the railroad industry has continued to trim expenses. As of August 1985, railroad industry employment totalled 305,326 employees compared to average employment levels of 324,696 employees for the year 1984 and 480,410 employees for the year 1980.

While the overall rate of return on investment (ROI) is still far below adequate levels, the railroad industry reported a ROI of 5.92 percent in 1984, the highest in 40 years.

The Staggers Act, the Commission's continuing implementation of the Act, the Economic Recovery Tax Act of 1981, and the consummation of various major railroad mergers have all contributed to strengthening the financial condition of the railroad industry. Thus, we remain convinced the Staggers Act can be credited with a significant improvement in the railroads' financial position.

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remain viable in the private sector of the economy; (4) to provide a regulatory process that balances the needs of carriers, shippers, and the public; and (5) to assist in the rehabilitation and financing of the rail system.

Certain groups [3] have sponsored research efforts designed to show that the railroads have not merely improved their financial condition relative to their revenue needs, but, in fact, are earning monopoly profits. These studies suggest that the railroad industry has amassed a surplus of capital and that certain railroads have become cash rich at the expense of the coal shippers who are purportedly being gouged by excessively high rates.

CURE alleges that the railroads have recovered from the financial problems that triggered the Staggers Rail Act of 1980. Its analysis of railroad earnings and expenditures allegedly shows that contrary to DOT forecasts, the railroads have generated a large surplus of capital from 1976 through 1985. CFA argues that the major coal hauling railroads are not revenue inadequate and that their cash positions combined with other financial indicators suggest that the Commission's revenue adequacy standard understates the financial condition of the industry. Both studies also imply that excessive coal rates are responsible for inefficient utilization of domestically produced coal. The EEI study proportedly demonstrates that coal transportation rates are excessive. The study provides estimates of prettax returns on investment on railroad movements to 19 utilities. EEI claims that these returns on investment range from 51% to 157% annually.

The Commission's staff has reviewed these studies and finds that they do not accurately depict the financial condition of the railroads and the earning power of their "captive" rates. Our staff was unable to verify the data used for these studies, and they are of the opinion that these studies employ assumptions which are inconsistent with the realities of the market place.

For example, the staff's review of the EEI study indicates that the methodology used to develop the returns is flawed because it seriously understates costs. From EEI's brief description of its methodology, it appears that the study defines profitability as any surplus over historical variable costs. This use of variable costs ignores overhead costs which must be covered through differential pricing and gives an illusion of high profitability. We would like to conduct a more comprehensive evaluation of EEI's study, but have been unable to obtain the necessary data underlying its study.

Copies of the staff analyses of the studies conducted by CURE, CFA, and EEI have been made available at this hearing.

Turning to the structure of the rail industry, since October of 1981, there has been continued rationalization of the rail industry as a result of our approval of a number of consolidations. Norfolk Southern Corporation was created by combining the Norfolk & Western and the Southern. A New England system was created under Guilford by consolidating the Maine Central, the Boston & Maine, and the Delaware & Hudson. In the middle and western part of the country, the Union Pacific acquired the Missouri Pacific and the Western Pacific. In the midwest, the Milwaukee has just emerged from bankruptcy to become a subsidiary of the Soo Line.

Although we have reached no conclusions in this matter, there is also currently pending before the Commission a merger proposal of the Santa Fe and the Southern Pacific.

In the intermodal area, CSX has acquired the ACL Barge Line operations, and Norfolk Southern has acquired North American Van Lines.

Finally, the DOT-approved purchase of Conrail by the Norfolk Southern is now pending before Congress.

This fast-changing scene has also given rise to coordination agreements between the Burlington Northern and the Grand Trunk and the Canadian National, and between the Burlington Northern and the Southern Pacific.

Turning to another important activity encouraged by Staggers, the proliferation of contract rate filings has continued since we last testified on this subject. Since passage of the Act, over 30,000 rate and service contracts have been filed with the Commission. We now receive about 1,150 new contract filings per month, from railroads and shippers of all sizes, covering virtually every commodity.

Use of contracts allows shippers and carriers to agree to rate and service levels without undue interference by the Commission. This activity is at the core of removing unnecessary regulations as encouraged by Staggers. For example, grain and coal are often thought to be commodities "captives" to railroads. Yet a survey of the top grain and coal hauling railroads indicated that in late 1984 approximately 41 percent of all grain tonnage was moving under contract and some 53 percent of all coal (domestic and export) was moving under contract.

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[3] Consumers United for Rail Equity (CURE), Consumer Federation of America (CFA), and Edison Electric Institute (EEI).

In March 1984, the Commission completed a special contract rate study which reviewed 12,301 contracts on file at that time. Some of the most significant findings were:

The growth in railroad rate and service contracts was quite impressive, as illustrated by the following breakdown of new contracts filed with the Commission: 15 months (Oct. 1980–Dec. 1981) 768 contracts; 12 months (Jan.–Dec. 1982) 3,248 contracts; 12 months (Jan–Dec. 1983) 8,285 contracts.

Contracts were filed by 147 railroads including all Class I carriers and many short lines.

The following Class I railroads accounted for 85% of all contracts on file: Chicago & North Western; Southern Pacific-Cotton Belt; Union Pacific—Missouri Pacific—Western Pacific; Chessie—Seaboard Systems; Burlington Northern; Conrail; Milwaukee; Santa Fe; Norfolk Southern; Missouri—Kansas—Texas; and Soo Line.

Contract revenues constituted an average of 26.5% of total revenues.

Almost all commodities were covered by contract agreements. These contracts contained a variety of rate and service provisions such as volume rate concessions, rate stability, improved car utilization, guaranteed car supply, guaranteed service, truck or barge competitive rates, and joint line contracts. The majority of contracts involved reduced rates or allowances in exchange for volume commitments by shippers. Most contracts were for a duration of one year or less although some contracts, particularly those involving coal, were for a duration of up to 39 years.

A breakdown of contracts on file January 1, 1984, by major commodity groups shows the following commodity activity:

Commodity group	Number of contracts	Percent
Bulk products, chemical, minerals, etc	3,021	24.6
Forest products, lumber, paper	2,220	18.0
Grain/grain products	1,792	14.6
Foodstuffs	1,586	12.9
Iron and steel	1,376	11.2
Coal	541	4.4
Auto, parts, machinery, implements	394	3.2
Other, service and miscellaneous commodities	1,371	11.1
Total	12,301	100.0

Since the March 1984 report was completed, contract rate activity has continued to accelerate. During the first 9 months of 1985, we have received over 10,000 new railroad rate contracts. There has been significant increase in grain contract activity in 1984–85 with grain/grain product contracts now representing about 25% of all contracts filed.

The Commission issued final rules for filing contracts (Ex Parte No. 387) which became effective January 4, 1983. These rules were challenged in the United States Court of Appeals for the Second Circuit by the Water Transport Association, joined by several ports and agricultural shippers. The issues involved the rights of water carriers to challenge contracts and the information available to the public in contract summaries.

In November 1983, the court, although approving our guidelines in general, found, in one respect, that our contract disclosures rules were too restrictive, and directed the Commission to promulgate additional rules consistent with its opinion. (*Water Transport Association* v. *ICC*, 722 F.2d 1025 (2d Cir. 1983)). We issued interim discovery rules on July 16, 1984, and requested additional comments. The comments are now under review and a Commission open conference has been continued from October 9, 1985 to December 11, 1985, giving the parties an opportunity to negotiate an agreement to resolve the discovery issue. To date, we have received 11 discovery petitions and complaints under our interim discovery rules, and have granted 5 out of the 11 petitions.

So far, we have not experienced any problems with respect to the carriers' statutory common carrier obligation vis-a-vis contract filings.

The Contract Advisory Service created by the Staggers Act continues to provide and assistance to shippers and railroads on contract matters. It is the focal point in the Commission for contract information and technical assistance. The Advisory Service, as required by the Act, has developed a mailing list of more than 2,500 in-

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terested shippers/carriers for dissemination of non-confidential contract summaries and information.

As you know, the Commission has directed its Office of Transportation Analysis to study joint rate and reciprocal switching cancellations. That study is nearing completion. The study covers the years 1981 to 1983 and is based on survey responses from 376 shippers and 189 receivers selected by random sampling. Independent samples of railroad inbound and outbound shippers were selected. Currently, the Office is completing final calculations on a weighted basis to correct for under-representation of small shippers and receivers in the sample. We anticipate a final report will be completed by December 1985.

We recognize that certain changes in railroad policy and operations—such as in the area of competitive access—have been unpopular with some groups. Accordingly, the Commission instituted two proceedings to address some of the perceived problems in this area.

By way of background, the Commission instituted a proceeding in Ex Parte No. 456, *The Staggers Rail Act of 1980—Conference of Interested Parties*, decided September 10, 1984, to gather information from carriers and shippers about the problems and benefits arising from the Staggers Act and to provide a forum for direct discussion among shippers and carriers. We initiated this proceeding to provide an opportunity for parties to deal directly with one another in the private sector under the auspices of, but without direction from, the Commission. Our purpose, in part, was to encourage private parties to negotiate mutually acceptable proposals for improving the implementation of the Staggers Act.

Two of the areas considered in that proceeding were competitive access (which included joint rates, through routes, reciprocal switching, joint terminal service, and trackage rights) and market dominance. Although no broad consenses was reached in the Ex Parte No. 456 proceeding, the National Industrial Transportation League (NITL) and the Chemical Manufacturers Association (CMA) reached individual agreements with the Association of American Railroads (AAR) in the area of competitive access. In addition, NITL and the American Paper Institute reached an agreement with the AAR in the area of market dominance. These agreements have been adopted virtually *in toto* by the Commission.

One of these proceedings, Ex Parte No. 445 (Sub-No. 1), *Intramodal Rail Competition*, covers competitive access standards. The Commission recently voted in an open conference on the various issues raised in that proceeding. The Commission has adopted, with minor modifications, the joint proposals by the AAR, NITL, and CMA for rules to govern Commission handling of the following competitive access issues: cancellation of through routes and joint rates, and prescription of through routes, joint rates and reciprocal switching. Although a written decision has not yet been published, we would like to briefly summarize the rules the Commission adopted.

These rules include:

(1) The railroads must give 45 days' notice of all cancellations and must provide, within 10 days of request, an explanation and justification of a proposed cancellation of a through route and/or joint rate. The carrier is to include pertinent mileage and cost data as part of its justification.

(2) A party intending to initiate a proceeding to challenge a cancellation of a joint rate or seeking the prescription of a through route, through rate or reciprocal switching arrangement, shall first negotiate to resolve its dispute with the prospective defendants. Participation in such negotiations will not waive a party's right to file a timely request for suspension and/or investigation.

(3) The Commission will suspend a proposed cancellation of a through route and/or joint rate where: (1) the cancellation would eliminate effective railroad competition; and (2) the shipper or railroad meets the requisite standing requirements (namely, that a protesting shipper has used or would use the through route and/or joint rate proposed to be cancelled to meet a significant portion of its current or future railroad transportation needs, or a protesting carrier has used or would use the through route and/or joint rate proposed to be cancelled for a significant amount of traffic).

(4) The Commission will find the cancellation of a through route/or a joint rate contrary to the public interest if it violates the competitive policies of section 10101a or is otherwise anticompetitive. To make this determination, the Commission will consider, among other things: (1) the revenue from the traffic moving over the routes and under the rates in question; (2) the efficiency and costs of the routes in question; (3) the rates charged or sought to be charged; and (4) the revenues and costs following cancellation.

(5) The Commission will prescribe a through route or a joint rate under section 10705, or reciprocal switching under section 11103, if the prescription is necessary to

remedy or to prevent an anticompetitive action, and a shipper or carrier meets the standing requirements described above.

(6) In making determinations concerning investigation or prescription in competitive access cases, the Commission will not consider product competition. In addition railroads wishing to rely on geographic competition will have the burden of proving the existence of such competition by clear and convincing evidence. Revenue inadequacy, standing alone, will not justify an anticompetitive action.

(7) Finally, the Commission adopted the policy that determinations in competitive access proceedings will not be given any res judicata or collateral estoppel effect in any litigation involving the same facts or controversy arising under the antitrust laws of the United States.

The second rulemaking proceeding, Ex Parte No. 320 (Sub-No. 3), *Product and Geographic Competition*, was also recently voted on by the Commission. Since there is not yet a published decision in that proceeding either, we would also like to summarize the Commission's rulings on various issues involved there.

These guidelines make it easier for a shipper to show that it is captive by:

(1) putting the burden of proving the existence of effective geographic or product competition on the railroads in all market dominance proceedings;

(2) stating that the fact a railroad faces geographic or product competition with respect to a receiver will not, in and of itself, establish the existence of effective geographic or product competition in relation to a producer, and vice-versa;

(3) placing the burden of proof on the railroads to show that receiver alternatives effectively restrain railroads vis-a-vis producers, and vice-versa;

(4) combining the present product competition guidelines' language into a concise summary which more clearly reflects present policy; and

(5) combining, summarizing, and revising the phrasing of the present geographic competitive guidelines for greater clarity and better reflection of present policy.

We will, of course, supply the Subcommittee with our formal decisions in these two proceedings as soon as they are available.

Another very important case recently decided by the Commission is Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines*. In our decision, served September 3, 1985, we adopted "Constrained Market Pricing" (CMP) guidelines for determining the maximum reasonable rate level that railroads may charge for the transportation of "captive" coal traffic.

In adopting the final coal rate guidelines, the Commission made significant changes to the interim guidelines in response to certain concerns raised by shippers. These changes include: (1) eliminiation of the proposed 15 percent limit on the amount that railroads may increase their rates on captive coal traffic in a single year (allowing for inflation) in favor of case-by-case scrutiny of the need for the phasing in of rate increases; (2) adoption of a long-run marginal cost standard to estimate any avoidable revenue need shortfall; and (3) clarification of the importance of "grouping" in stand-alone cost presentations.

The CMP guidelines we adopted provide that:

Captive shippers should not be required to pay more than necessary for the rail carrier(s) involved to earn adequate revenues.

Captive shippers should not bear the cost of any facilities or services from which no benefits are derived.

A captive shipper's responsibility for payment for facilities or services which are beneficially shared by other shippers will be apportioned according to the individual demands of the various shippers. Thus, railroads will have an incentive to ensure that competitive traffic contributes as much as possible toward facility or service costs.

Changes in coal rates should not be so precipitous that they cause severe economic dislocations.

We believe that these guidelines will provide the necessary protection for captive shippers, and, at the same time, will provide the railroads the opportunity to earn adequate revenues.

As for the use of the savings provision (i.e., section 229 of the Act) shippers timely filed 864 complaints under this provision. As of October 7, 1985, 835 have been dismissed, in most instances due to settlements reached by the parties.[4] Of the remaining 29 cases, at least 15 are likely to be settled. Of the remaining 14, 13 are now being held up at the request of the complainant, or are instrastate in nature, and one is in the record-building stage with special procedures. The latest continuing Report on the Docket Management of these complaints is attached as Appendix III to this statement.

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[4] Of these 835 cases, 767 were dismissed at complainant's request (or with complainant's acquiescence); the preponderance of these dismissals were based on negotiated settlements. The remaining 68 cases were dismissed by initial decisions of an Administrative Law Judge. While some of these initial decisions are on appeal to the Commission, a number have also been dismissed as complainant's request.

Another important Staggers Act change is the expansion of the Commission's exemption authority under 49 U.S.C. § 10505. The Commission is required to use its exemption authority when the Commission finds that regulation is unnecessary to effectuate the rail transportation policy of section 10101a; and either (1) the transaction or service is of limited scope; or (2) regulation is not necessary to protect shippers from the abuse of market power.

Since passage of the Staggers Act, the Commission has modified and streamlined its exemption procedure. Certain of the most significant exemption are listed in the title-by-title analysis.

Effective competition is the key to the success of the Staggers Act and its implementation. An environment where efficiency, flexibility, and adequate revenues are encouraged will promote such competition and the related benefits. The Commission is implementing the Act with this in mind. Where there is a lack of effective competition, the Commission will continue to provide captive shippers protection against unreasonable rates. Meanwhile, by eliminating burdensome regulations and practices which tended to stifle innovative rail management, the Commission is attempting to promote more efficient operations. Innovative ratemaking and marketing have been encouraged and supported. The direct connector restriction imposed on collective ratemaking and the emphasis on independent actions and contracts have resulted in more competitive and responsive rate and service levels. Simplified requirements for constructing and operating new rail lines, and mandatory reciprocal switching agreements, where warranted, will result in stronger intramodal competition. Rail lines formerly in financial difficulty, such as the B&M Corporation and the D&H Railway Company, have been revived, and will offer extended service and competition in their region.

In sum, we believe that the Staggers Act is working and working well. I would like to turn now to a more in-depth discussion of particular provisions of the Act and the Commission's implementing decisions.

TITLE-BY-TITLE ANALYSIS OF THE IMPLEMENTATION AND EFFECTS OF THE STAGGERS ACT

Title II—Railroad Rates and Inter-Carrier Practices

Under this Title, the railroads have been permitted substantially more rate freedom than was afforded them prior to the Staggers Act. Generally, in the absence of market dominance, a rail carrier may establish a rate at any level it desires (absent discrimination) as long as it contributes to going concern value. The Title also establishes a revenue-variable cost threshold below which the Commission has no jurisdiction over the maximum reasonable level of rates. If the carrier has market dominance and the rate exceeds the jurisdictional threshold, the Commission, on complaint or protest, is authorized to determine whether the rate is reasonable.

In determining whether a rate is reasonable, the Commission is required to recognize the policy that rail carriers are to earn adequate revenues. In essence, this Title eliminates rate regulation where there is effective competition. It also encourages carriers to use new marketing techniques such as contracts, permissive limited liability rates, and premium or reduced charges to encourage better car utilization. Provisions in this Title also simplify coordination, minor merger procedures, entry, and reciprocal switching agreements. Finally, Title II requires the Commission to use its expanded exemption authority so as to regulate only where necessary to promote the rail transportation policy and to protect against abuses of market power.

To implement this Title, the Commission has issued numerous decisions interpreting the statutory changes. Appendix I to this statement provides, by Staggers Act section, a brief summary of all of these proceedings. At this point, we would like to set out the provisions of Title II and discuss the major proceedings instituted by the Commission to implement this Title.

Section 201.—This section allows a rail carrier to establish any rate for transportation unless the carrier has market dominance over the transportation, in which case the rate must be reasonable. In implementing this section, the principal issue has been the standard for maximum rate reasonableness for captive coal traffic. Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines*. Because of the significance of this case, and how it shows the evolution in the Commission's thinking on the subject of rate reasonableness, we will discuss it in detail.

In a decision served September 3, 1985, the Commission adopted a maximum rail rate policy applicable to captive coal traffic. The "Constrained Market Pricing" (CMP) guidelines ensure that: (1) a carrier does not use its market dominance to charge captive coal shippers more than they should have to pay for efficient rail service (the stand-alone cost analysis); (2) a shipper will not subsidize long-term excess capacity, fund revenue shortfalls which could be eliminated by pricing noncaptive traffic at the full level demand would support, or bear the costs associated with avoidable inefficiencies (the long-run marginal cost/avoidance revenue shortfall and management efficiency analysis); (3) a carrier charges only that amount appropriate to its revenue needs (the revenue adequacy constraint); and (4) precipitous changes in the coal rate structure do not cause severe economic dislocations.

These guidelines represent the culmination of the Commission's efforts to arrive at a formula for prescribing maximum reasonable coal rates. To achieve the revenue adequacy goals of the Staggers Act, railroads should be able to assess rates high enough to recover, on a system-wide basis, all variable costs and constant costs, including a return on investment equal to the current cost of capital. The difficulty with achieving this objective is that not all individual rail movements can be priced at this level, mainly due to varying forms of competition. This contrasts, for example, with electric utility ratemaking, where users generally have no other option, and where constant costs can be more easily prorated. In contrast, to reach revenue adequacy, railroads have to price differentially on the basis of demand or, in other words, allocate constant costs disproportionately among users of the system.

In earlier stages of this proceeding, the Commission considered the use of fully allocated costs as a maximum rate standard, employing various constant cost allocation methodologies—ratio method, revenue additive, and ton/ton/-mile. Ultimately, each of these methods was found somewhat arbitrary, and not based on sound economic or regulatory considerations. Accordingly, they were rejected.

In its September 3 1985, decision, the Commission has adopted a modification of the theoretical framework of Ramsey pricing to allocate constant cost. Basically, the Ramsey pricing framework assigns to individual movements a mark-up above marginal cost on the basis of inverse demand elasticity. This approach yields economically efficient rates and the proper allocation of constant costs. In effect, it simulates a marketbased price.

The modifications of the Ramsey pricing model were adopted for practical reasons. Ramsey pricing is based on a mathematical formula which requires precise calculation of the elasticity of demand and marginal cost for every movement. The Commission concluded that, since we do not have such data and it would be difficult and extremely burdensome to develop, pure application of the Ramsey pricing model would be inappropriate. However, the Commission believes that the "market forces" theory behind Ramsey pricing is relevant and can be relied on in conjunction with the regulatory constraints outlined above.

The decision in Ex Parte No. 347 (sub-No. 1) also brings into play the "Long-Cannon" efficiency factors of section 203(a) of the Staggers Act. These factors require that, in judging rate reasonableness, the Commission consider: (1) the amount of traffic that fails to contribute to going-concern value and the carrier's efforts to minimize such traffic; (2) the amount of traffic that contributes only marginally to fixed costs and the extent to which rates on such traffic can be raised; and (3) the carrier's mix of traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

In No. 38754, *Arkansas Power & Light Co.—Amendment—Staggers Act*, 365 I.C.C. 983 (1982), *aff'd. Arkansas Power & Light Co.* v. *ICC*, 725 F.2d 716 (D.C. Cir. 1984), the Commission rejected a proposal by several public utilities to institute a rulemaking to establish a data base to allow us to adjust individual carrier's total revenue need shortfall by eliminating an "avoidable" revenue shortfall portion. Petitioners argued this was a needed method to give appropriate consideration to the Long-Cannon factors. For many reasons, we concluded it was inappropriate to establish such a data base or to conduct a general scrutiny of carriers' pricing efficiency outside the context of particular rate disputes, but we did encourage parties to present Long-Cannon evidence in individual rate proceedings.

We affirmed that approach in Ex Parte No. 347 (Sub-No. 1). However, we adopted many of petitioners' approaches for use in analyzing plant and pricing inefficiencies under the management efficiency constraint is the use of the long-run marginal cost concept (LRMC). The Commission determined that if the market cannot support a rate level which, over time, yields a return on investment sufficient to replace assets attributable to a particular service, then replacement of these assets is not economically justified. By using LRMC to determine which traffic does not yield revenue to cover that level, a carrier's total revenue need shortfall can be reduced by this "avoidable" portion. The use of LRMC as a tool to measure a railroad's long-run efficient plant conforms with one of CMP's underlying principles, namely, that captive coal shippers should not pay for facilities from which they clearly derive no benefit.

Petitions for judicial review of earlier stages of the Ex Parte No. 347 (Sub-No. 1) proceeding are being held in abeyance in the United States Court of Appeals for the Third Circuit in No. 82-3113, *Western Coal Traffic League, et al.* v. *United States, et al.* and consolidated cases. The petitioning shipper groups have moved to dismiss that litigation, however, contending that the board guidelines issued by the Commission are not ripe for review.[5]

One court has already had an opportunity to review major portions of the maximum rate guidelines. Following the decision in *Potomac Electric Power Co.* v. *United States*, 702 F.2d 1026, modified, 705 F.2d 1343 (D.C. Cir. 1983) requiring the Commission to decide a pending rail complaint within a court-imposed deadline, the Commission decided the case based upon the interim guidelines as proposed in the February 1983 notice. The Commission concluded that the shipper had failed to prove its case and dismissed the complaint. The court affirmed the Commission's application of the proposed guidelines over challenges to both the procedure and merits of the standards. *Potomac Electric Power Co.* v. *ICC*, 744 F.2d 185 (D.C. Cir. 1984).

Section 202.—This section deals with the determination of market dominance. Congress established a jurisdictional level blow which the Commission has no maximum rate reasonableness authority. If a rate is below a certain revenue to variable cost ratio, the Commission must find that the rail carrier does not have market dominance and, therefore, that the Commission does not have jurisdiction.

However, the concept of market dominance involves more than just numerical ratios. In Ex Parte No. 320 (Sub-No. 2), Market Dominance Determinations and Considerations of Product Competition, the Commission found that the prior rebuttable presumptions of market dominance based on cost, market share, and substantial investment should be replaced with general guidelines related to intramodal, intermodal, product, and geographic competition.

A divided panel of the United States Court of Appeals for the Fifth Circuit set aside the Commission's market dominance regulations, but the Commission's petition for rehearing was granted. On rehearing en banc, the court reversed the panel and affirmed the Commission's market dominance regulations, including the controversial decision to consider evidence of geographic and product competition. *Western Coal Traffic League* v. *United States*, 719 F.2d 772 (5th Cir. 1983). In upholding the Commission's decision to consider both of those indirect forms of competition, the court relied on the overall Congressional goal (originally expressed in the 4R Act, and reemphasized in section 202 of the Staggers Act) of deregulating rail rates subject to effective competition.

Recently, the Commission voted to revise its guidelines governing product and geographic competition. In Ex Parte No. 320 (Sub-No. 3), Product and Geographic Competition, the Commission voted at a public conference on July 31, 1985, to adopt revised rules that will: (1) place the burden of proving the existence of effective product or geographic competition on the railroads in all cases; (2) establish that the showing of product or geographic competition with respect to a receiver would not, standing alone, establish the existence of such competition with respect to an originator, and vice-versa; (3) consolidate the current product competition guidelines; and (4) make certain changes in the wording of the geographic competition guidelines. A decision based on this vote will be issued shortly.

Section 203.—In this section, Congress established a mechanism to allow carriers to offset inflation by raising their rates without challenge. It also established a zone of rate flexibility within which the carrier could adjust rates without regulatory interference.

Section 203 requires the Commission to publich, at least quarterly, a rail cost adjustment factor (RCAF). This mandate has been implemented by rules established in Ex Parte No. 290 (Sub-No. 2), Railroad Cost recovery Procedures.

The Commission has two projects involving this proceeding. One is the review of the Association of American Railroad's (AAR) Quarterly Index and the publication of the RCAF computed from this index.

Final rules for the calculation of a substantially modified version of the all-inclusive index of railroad costs originally proposed by the AAR were served on January

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[5] One shipper has filed a separate petition for review in the United States Court of Appeals for the Sixth Circuit. The Commission has filed a motion to dismiss that case or, alternatively, to transfer it to the Third Circuit and consolidate it with the other petitions. The Commission has not taken a position as of this date on the shippers' motion to dismiss.

2, 1985. These rules substituted individual railroad specific factors for the former "all other" index component which had been measured by the Producer Price Index. The timetable for submission and processing of quarterly index data was changed in order to increase the notice period from one to ten days.

Subsequently, AAR petitioned for a shortened notice period for competitive rate reductions because of the elimination of collective ratemaking immunity. Certain shipper parties have also requested modifications to parts of the new indexing methodology. These petitions are currently under consideration.

The other proceeding is Ex Parte No. 290 (Sub-No. 4), Railroad Cost Recovery Procedures—Productivity Adjustment. A Notice of Proposed Rulemaking requesting specific comments on the various proposals for measuring railway productivity, the discounting of the index of a profit element, and whether a productivity adjustment should be adopted was served on September 27, 1984. Comments and replies have been submitted and are currently being analyzed.

Section 203 also sets forth the so-called "Long-Cannon" factors that are to guide the Commission in its determination of rate reasonableness. As discussed above, the Commission has developed a method to consider these factors within the context of its coal rate guidelines.

Finally, section 203(b) included a provision dealing with a specific pending maximum rate reasonableness case involving the City of San Antonio, TX. Pursuant to the provision, the Commission has excluded that portion of the proceeding that involves rates in existence on and after the effective date of the Staggers Act from being governed by the coal rate guidelines. This case, No. 36180, *San Antonio, TX, Acting by and through Its City Public Service Board* v. *Burlington Northern R.R. Co. et al*, is currently pending before the Commission.

Section 204.—This section provides that rates for nonferrous recyclables shall not exceed a Commission determined revenue-to-variable cost (r/vc) ratio. The statute provides that the ratio must enable the carriers to cover total operating expenses plus a reasonable profit. We calculated the ratio to be 146 percent and ordered the carriers to refrain from increasing nonferrous recyclables if the rates would exceed the prescribed level. The Commission did not order immediate reductions because it was anticipated that cost increases would reduce the ratio levels. This decision was remanded in part in *National Ass'n of Recycling Industries* v. *ICC*, 660 F.2d 795 (D.C. Cir. 1981), where the court concluded that immediate reductions must be ordered for rates exceeding the prescribed level.

On remand, the Commission ordered the carriers to reduce the rates to the prescribed level. At the suggestion of the carriers and recycling interests, the carriers were permitted to use regional cost and revenue data developed for each commodity in a then-recent across-the-board rate increase proceeding in computing the initial basis for the reductions. While these adjustments would achieve compliance in the aggregate, the adjustments would result in some individual rates above the cap and some below. To mitigate the impact of any serious distortions, the Commission expressly authorized individual rate adjustments by the carriers and individual compliant proceedings by the shippers.

In a 1982 decision, the Commission concluded that the carriers' nonferrous recyclable rates were generally in aggregate compliance, but identified certain areas in which further aggregate reductions were needed. In a 1983 decision, the Commission further concluded that the carriers' rates, excluding Conrail's [which had been found in compliance earlier in Restructured Rates on Recyclables, Steel Scrap—Conrail, 365 I.C.C. 596 (1982)], complied with the rate cap order, and that these carriers' rates vis-a-vis Conrail also complied [a finding necessitated by the court decision in *National Ass'n of Recycling Industries* v. *ICC*, 704 F.2d 638 (D.C. Cir. 1983)]. The Commission also addressed a railroad petition for a declaratory order that individual complaints were improper when aggregate compliance is achieved. In *Norfolk & Ry. Co.* v. *ICC* ——U.S.C.A. ——, D.C. Cir., No 83-2296, decided July 19, 1985, the court reversed the Commission's decision that authorized individual complaints. The Commission's decision that authorized individual complaints. The Commission has filed a petition for clarification.

In Ex Parte No. 394 (Sub-No. 1), the Commission ordered ratios established for calendar years 1982, 1983, 1984, and 1985. Ratios for the years 1982 through 1984 were for the purpose of calculating reparations that may be due in individual complaint cases. The Commission also authorized quarterly updating of the recyclable rates, the annual calculation of the r/vc ratio, and prescription of the ratio to an accuracy of 0.1 percent, Finally, the Commission granted the railroads' request for relief from initiating refunds.

Section 205.—This section accomplished two different goals. First, it required the Commission to determine whether product competition should be considered in rate reasonableness proceedings. In response to this directive, the Commission instituted Ex Parte No. 320 (Sub-No. 2), which examined this issue and concluded that product competition is more appropriately considered at the market dominance rather than the reasonableness stage.

This section also focused on the question of revenue adequacy. In Ex Parte No. 393, Standards for Railroad Revenue Adequacy, 374 I.C.C. 803 (1981), the Commission determined that a railroad will be considered revenue adequate if it has a rate of return equal to the current cost of capital. This standard was found necessary to permit railroads to compete in capital markets and be financially healthy over the long term. The Commission's decision was affirmed by the United States Court of Appeals [6] and the Supreme Court denied certiorari.

In Ex Parte No. 393 (Sub-No. 1) Standards for Railroad Revenue Adequacy, the Commission proposed to improve the standards adopted in Ex Parte No. 393 for determining railroad revenue adequacy. Specific proposed revisions to the present standards are:

(1) Calculation of return on investment (ROI) to consider exclusively all transportation elements of income, expense, and investment.

(2) Use of normalized or weighted normalized data for four years to compute ROI.

(3) Computation of ROI on a consolidated basis to include transportation affiliates of railroads.

(4) Conversion from an original cost investment base to one based on current costs. Revenue adequacy would be determined by comparing the return on a railroad's investment base valued at depreciated reproduction costs to the current real cost of capital (nominal cost less the current inflation rate).

(5) Use of current cost information in other regulatory proceedings.

A draft decision in Ex Parte No. 393 (Sub-No. 1) is under review.

Section 206.—This section gave the Commission the authority to establish a percentage rate increase or index to allow carriers to cover inflation. The Commission decided not to use this section and has, instead, relied on the mechanism established in section 203.

Section 207.—This section sets forth the procedures and standards for Commission suspension of rates.

Shipper dissatisfaction with joint rate cancellations led to attempts to have the Commission develop clearer standards as to suspension of these cancellations. In Ex Parte No. 445, Standards for Intramodal Rail Competition, the Commission denied a petition by shippers and railroads to adopt one set of standards to judge effective competition in all cases. It preferred to approach the matter through individual analysis and adjudication.

In Ex Parte No. 456, The Staggers Rail Act of 1980—Conference of Interested Parties, the Commission encouraged railroads and shippers to discuss and attempt to resolve problems arising from implementation of the Staggers Act. As a result of these discussions, the Association of American Railroads (AAR), the National Industrial Transportation League (NITL), and the Chemical Manufacturers Association (CMA) proposed rules to govern the Commission's handling of what are generally referred to as "competitive access" issues, i.e., cancellation of joint rates and through routes, and the prescription of joint and proportional rates, through routes, and reciprocal switching. Later, Railroads Against Monopoly (RAM), a group of regional railroads, proposed rules containing more specific criteria than those found in the AAR/NITL/CMA proposal.

As a result of these proposed rules, the Commission instituted Ex Parte No. 445 (Sub-No. 1), Intramodal Rail Competition. After considering various comments and having oral argument, the Commission voted in open conference on September 11, 1985, to adopt, with certain modifications, the ARR/NITL/CMA proposal. The rules the Commission has voted to adopt call for notification, explanation, and justification prior to bringing a proceeding before the Commission. They also provide that, if certain standing requirements are met, the Commission will suspend a proposed cancellation of a through route and/or joint rate if the cancellation would eliminate effective railroad competition. The rules further provide broad criteria under which the Commission will investigate cancellations and prescribe through routes, through rates, and reciprocal switching. The Commission decided that in investigation and prescription proceedings it would not consider product competition and that, if the railroad wishes to rely on geographic competition, it will have the burden of proving

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[6] *Bessemer & Lake Erie R.R.* v. *I.C.C.*, 691 F.2d 1104 (3d. Cir. 1982), Cer. denied, 103 S.Ct. 2463 (1983).

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the existence of such competition by clear and convincing evidence. The Commission's decision will be served shortly.

Section 208.—This section allows contracts between rail carriers and purchasers of rail services. Its major provisions include: general confidentiality of contracts; public disclosure of the essential contract terms; requirements for filing contracts; requirements for standing to complain and grounds for complaints; grounds on which complaints may be filed; the extent of Commission and court jurisdiction; dedication of railroad equipment for rail contracts; and the establishment of an advisory service.

The Commission adopted rules, Ex Parte No. 387, Railroad Transportation Contracts, 367 I.C.C. 9 (1982), which provided procedures and rules to govern filing the contract and contract summary (the latter discloses the essential contract terms to the public), discovery, standards for filing and adjudicating complaints, standing, car dedication, and time limits on Commission jurisdiction.

In *Water Transportation Ass'n* v. *ICC*, 722 F.2d 1025 (2d Cir. 1983), the court substantially affirmed the Commission's regulations. The court upheld in all respects the Commission's contract-summary tariff rules, which limit in certain respects the information that contracting parties are required to publicly disclose in filing contract tariffs. The court did, however, require the Commission to promulgate additional regulations to govern the discovery process in complaint proceedings challenging rail contracts.

By notice served July 13, 1984, interim rules for discovery were served and comments requested. The comments are now under review and a Commission open conference has been continued from October 9, 1985 to December 11, 1985, giving the parties an opportunity to negotiate an agreement to resolve the discovery issue.

Section 209.—This section repealed former 49 U.S.C. 10727. As a result, the Commission in 1980 repealed its regulations regarding seasonal, regional, or peak-period demand rates.

Section 210. This section repealed a provision dealing with capital incentive rates. As a result, the Commission in 1980 repealed its capital incentive rate regulations.

Section 211. This section amended the method by which rail carriers could limit their liability for loss or damage. The Commission established standards to implement this provision in 1980. Pursuant to this section's directive, the Commission submitted a report concerning carrier liability to Congress in 1981.

Section 212. This section more clearly defined what constituted discrimination and made it more difficult, except for ports, for parties to use claims of unjust discrimination to hamper railroad ratemaking. No Commission action was necessary.

Section 213. In one of the key provisions of the Staggers Act, the Commission was granted broad discretion to exempt a person or transaction from regulation. Congress specifically indicated that, although it was able to identify certain areas worthy of reduced regulation, the Commission should continue to search for areas where reduced regulation was needed. The Commission has used this power to exempt whole classes of persons and transactions, as well as to exempt minor individual transactions. Certain of the most significant exemption decisions are listed below.

Ex Parte No. 230 (Sub-No. 5). In 1981, the Commission exempted from regulation rail and truck service provided by rail carriers in connection with trailer-on-flat-car (TOFC) and container-on-flatcar (COFC) service.

Ex Parte No. 230 (Sub-No. 6). In 1984, the Commission voted to exempt the over-the-road truck service of railroad affiliated motor carriers and other motor carriers. A draft decision is under review.

Ex Parte No. 346 (Sub-No. 7). In 1983, the Commission exempted all export coal traffic moving through all U.S. ports.

In *Coal Exporters Ass'n* v. *ICC*, 745 F.2d 76 (D.C. Cir. 1984), cert. denied, 53 U.S.L.W. 37772 (U.S. No. 84-884, April 15, 1985), the United States Court of Appeals for the District of Columbia Circuit reversed and remanded the Commission's export coal exemption. The principal basis for the reversal was the court's conclusion that the Commission had applied an unreasonable standard for measuring the potential for abuse of rail power in a deregulated export coal market.

In July of 1985 certain railroads filed a notice of intent to file a petition to reopen the Export Coal proceeding.

Ex Parte No. 346 (Sub-No. 8) and Ex Parte No. 346 (Sub-No. 19). In 1983, the Commission, in the Sub-No. 8 proceeding exempted boxcar movements of all commodities, except nonferrous recyclables, from rate regulation. This decision also modified the way in which compensation was determiend for the use of boxcar equipment. The Commission adopted a proposal to allow user railroads: (1) to assess charges for empty movements made at the request of the car owner, the AAR, or the Commission (these charges could not exceed 35 cents per mile, the approximate cost of pro-

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viding the movements); (2) to store empty cars and reclaim car hire payments at the expiration of a 72-hour grace period after the car is emptied; and (3) to negotiate compensation agreements with the boxcar owners for car hire, empty movements, and storage. Other aspects of regulation, including mandatory interchange, car supply, and car hire and car service, where agreements could not be reached, were retained by the Commission.

Upon review, the court affirmed the Commission's essential finding that regulation of single line boxcar rates is unnecessary to protect shippers from an abuse of market power. The court remanded the exemption as it applies to joint line boxcar rates for a further explanation of: (1) whether under an exemption carriers would close efficient through routes; and (2) whether the division of profits for small carriers would be inadequate to preserve their financial health. This proceeding has been reopened, and the issue of the joint line rate exemption is the subject of further analysis.

The court also invalidated the partial car hire exemption because it found, among other things, that it was more like a rule than an exemption. The Commission has instituted a new rulemaking, Ex Parte No. 346 (Sub-No. 19), to consider alternative approaches to improving the efficiency of boxcar use and making car rental charges more responsive to market conditions. This proceeding is pending.

Ex Parte No. 274 (Sub-No. 8). In 1983, the Commission exempted from regulation the abandonment of railroad lines when the line had been out-of-service for at least two years. The exemption was later modified to be unavailable if (1) the line was the subject of a complaint filed by a government entity regarding a demand for service (previously only a complaint by a user was relevant); and (2) the line was the subject of a complaint pending with any U.S. Federal District Court. In a related proceeding, Ex Parte No. 274 (Sub-No. 8A), the exemption was made available for persons seeking to discontinue service.

Ex Parte No. 282 (Sub-No. 9). The Commission exempted from regulation trackage rights proposals and renewals of existing trackage rights agreements if they are in writing and are not filed or sought in responsive applications in rail consolidation proceedings.

Ex Parte No. 392 (Sub-No. 1). The Commission has proposed to exempt from regulation all acquisitions and operations under section 10901 unless the proposal would result in a major market extension. The proposal would include acquisition by a noncarrier of rail property to be operated by a third party and operation by a new carrier of rail property acquired by a third party.

Ex Parte No. 397. The Commission voted October 16, 1985, to exempt securities issued or assumed by: (1) Class II and III rail carriers; (2) a party acquiring a rail line under the offer of financial assistance procedures of 49 U.S.C. 10905; and (3) any rail carrier issuing equipment trust certificates. Most issuances by Class I railroads and their holding companies will also be exempt, subject to the filing of a notice and an opportunity to protest. A decision will be published soon.

Section 214.—This section requires States seeking to regulate the intra-state rates, classifications, rules, and practices of rail carriers to apply to this Commission for certification of the standards and procedures under which they regulate. To certify them, we must find that these standards and procedures are in accordance with Federal law.

A number of States did not participate in the certification program. To date, six States have asked the Commission to assume jurisdiction over their intrastate rates, and the Commission has done so. Those States are: Alaska, California, Connecticut, Delaware, Nevada, and North Carolina. Additionally, South Dakota specifically requested that the Commission not assume jurisdiction over its traffic; accordingly the Commission did not assert jurisdiction. Six states and the District of Columbia did not respond to the filing requirements and have lost jurisdiction over their intrastate rail traffic. These States are: Arizona, Hawaii, Maine, Massachusetts, Rhode Island, and Vermont.

Certification of individual States has been considered in Ex Parte No. 388, State Intrastate Rail Rate Authority. Of the States that have applied for certification, the Commission has finally certified 23. Those States are: Alabama, Arkansas, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Michigan, Mississippi, Missouri, Montana, New Hampshire, New Mexico, New York, North Dakota, Oregon, South Carolina, Tennessee, Virginia, West Virginia, and Wisconsin.

Seven States have been provisionally certified to permit them to regulate intrastate transportation while revising their standards in order to obtain final certification. Those States are: Colorado, Louisiana, Minnesota, Nebraska, Oklahoma, Utah, and Washington.

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Six States applied but later withdrew their applications and requested the Commission to take jurisdiction. The Commission did so. Those States are: Florida, Idaho, New Jersey, Ohio, Pennsylvania, and Wyoming.

Litigation arising out of the Commission's implementation has produced several significant judicial opinions on various aspects of the new federal-state scheme created by section 214. First and foremost, the constitutionality of the provision has been affirmed over several attacks. In *State of Texas* v. *United States*, 730 F.2d 339 (5th Cir. 1984) cert. denied, 105 S. Ct. 267 (1985), the Court of Appeals, affirming a district court order granting summary judgment to the Government, held that section 214 constituted a valid exercise of the commerce clause power and did not violate the 10th Amendment, See also *State of Texas* v. *ICC*, 730 F.2d 409, (5th Cir. 1984), amended on rehearing, 749 F.2d 1144 (1985), cert. denied, 105 S. Ct. 3513 (1985) (10th Amendment argument rejected in challenge to ICC reversal of Texas Railroad Commission decision under section 214).

Although section 214 contemplated final ICC certification of state authorities within a very short period, the ICC determined early on that the complexity of the issues involved required use of an interim process whereby states submitting compliance plans received provisional certification. This procedural mechanism received judicial approval in *Illinois Central Gulf R.R.* v. *ICC*, 720 F.2d 950 (7th Cir. 1983).

The first authoritative judicial construction of the Staggers Act mandate to conform state regulation to federal "standards and procedures" was *Illinois Central Gulf R.R. Co.* v. *ICC* ("*ICG I*"), 702 F.2d 111 (7th Cir. 1983). There the ICC affirmed a Kentucky Railroad Commission order despite the state agency's failure to follow a line of ICC cases enforcing demurrage agreements. The Seventh Circuit reversed, interpreting section 214 as requiring states to follow "consistent rulings of the ICC" as part of their federally supervised "standards and procedures." 702 F.2d at 115.

Subsequently, it became well established that both ICC decisional precedent as well as regulations are part of the federal "standards and procedures" to which states must conform in order to exercise post Staggers Act rail jurisdiction. See e.g., *Wheeling-Pittsburgh Corp.* v. *ICC*, 723 F.2d 346 (3d Cir. 1983) (Congress intended the term "standards and procedures" to encompass standards and procedures, promulgated and interpreted by decisions of the ICC); State of Texas, supra, 730 F.2d 409 (Texas intrastate regulations pertaining to rail contract rates preempted by inconsistent ICC promulgated regulations). In addition, it is now well established that states, in exercising jurisdiction over intrastate matters, must comply with ICC decisions exempting certain commodities or classes of rail traffic from regulation under section 10505 of the Act. *Illinois Commerce Commission* v. *ICC*, 749 F.2d 875 (D.C. Cir. 1984), cert denied 59 U.S.L.W. 3227.

One State, Texas, was denied certification for failure to conform to Federal standards and procedures. The decision was affirmed in *Railroad Comm'n of Texas* v. *ICC*. — F.2d -- (D.C. Cir. June 21, 1985).

The following chart gives the status of all the Commission actions involving state certification.

EX PARTE NO. 388 CHART

State (Sub No.)	Date of most recent action	The action
Alabama (1)	Dec. 12, 1984	Final certification.
Arkansas (2)	Feb. 22, 1984	Do.
Colorado (3)	June 6, 1985	2d extension of provisional certification. Submission under review.
Florida (4)	Aug. 15, 1984	ICC took jurisdiction as of 10/1/85. [State withdrew application.]
Georgia (5)	Nov. 30, 1984	Final certification.
Idaho (6)	Oct. 22, 1984	ICC took jurisdiction. [State withdrew application.]
Illinois (7)	Jan. 27, 1983	Final certification.
Indiana (8)	Nov. 28, 1984	Do.
Iowa (9)	Nov. 30, 1984	Do.
Kansas (10)	Feb. 15, 1985	Do.
Kentucky (11)	Oct. 23, 1985	Do.
Louisiana (12)	Oct. 10, 1984	Extension of provisional certification. Awaiting compliance.
Maryland (13)	June 26, 1985	Final certification.
Michigan (14)	June 21, 1985	Do.
Minnesota (15)	Jan. 9, 1985	Extension of provisional certification.
Mississippi (16)	Aug. 21, 1984	Final certification.

EX PARTE NO. 388 CHART—Continued

State (Sub No.)	Date of most recent action	The action
Missouri (17)	Nov. 30, 1984	Do.
Montana (18)	Nov. 28, 1984	Do.
Nebraska (19)	Aug. 27, 1984	Extension of provisional certification for revisions. [Awaiting compliance.]
New Hampshire (20)	July 17, 1984	Final certification.
New Jersey (21)	Oct. 3, 1983	ICC took jurisdiction [State withdrew application.]
New Mexico (22)	Nov. 30, 1984	Final certification.
New York (23)	Nov. 1, 1984	Do.
North Dakota (24)	June 12, 1984	Do.
Ohio (25)	Sept. 26, 1984	ICC took jurisdiction. [State withdrew application.]
Oklahoma (26)	Oct. 3, 1984	Extension of provisional certification for revisions. [Awaiting compliance.]
Oregon (27)	Sept. 24, 1985	Final certification.
Pennsylvania (28)	June 13, 1983	ICC took jurisdiction. [State withdrew application.]
South Carolina (29)	Feb. 22, 1984	Final certification.
Tennessee (30)	Feb. 22, 1984	Do.
Texas (31)	Apr. 20, 1984	Decertified.
Utah (32)	Oct. 10, 1984	Extension of provisional certification for revisions. Awaiting compliance.
Virginia (33)	July 27, 1983	Final certification.
Washington (34)	May 23, 1983	Provisionally certified. Letter stating problem in submission. Revisions received 4-11-85.
West Virginia (35)	Feb. 22, 1984	Final certification.
Wisconsin (36)	Jan. 4, 1985	Do.
Wyoming (37)	Feb. 22, 1983	ICC took jurisdiction. [State withdrew application.]
Alaska (38)	June 3, 1985	ICC took jurisdiction at State's request.

Section 215.—This section provides that business solicitation and entertainment expenses incurred by railroads do not constitute illegal rebates or discrimination. The Commission adopted procedures implementing this section.

Section 216.—This section establishes time frames for tariffs increasing and reducing rates to become effective. The Commission adopted rules implementing this section.

Section 217.—This section permits a carrier, with a minimum of regulatory interference, to apply surcharges or directly cancel routes if the carrier is earning inadequate revenues.

Section 217 required the Commission to furnish its determination of the variable costs and revenues of portions of surcharged or cancelled rates. This mandate has been implemented through rules established in Ex Parte No. 389, Railroad Surcharge and Cancellation Procedures.

The Commission continued to supply cost and revenue information to requesting parties through September of 1984, at which time, the authority to apply a surcharge expired by operation of law. Requests for costing declined since the implementation of the program in November 1980, as indicated by the following:

Year	Surcharge costing requests		Cancellation costing requests	
	Number of requests	Total movements represented	Number of requests	Total movements represented
1980 [7]	8	136		
1981	262	26,096	77	7,895
1982	30	2,272	6	31
1983	11	433	1	1
1984	1	4		

[7] Represents November and December 1980.

Section 218.—This section expedites evidentiary proceedings dealing with divisions of joint rates. The Commission adopted procedures implementing this section in

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1983, in Ex Parte No. 322 (Sub-No. 1) *Revised Procedure for Divisions of Revenue Cases*, 367 I.C.C. 353 (1983).

Section 219.—This section deals with the permissible activities of rate bureaus and limits the ability of bureaus and their members to engage in rate discussions. Specifically, this section permits railroads to discuss rate changes only with their "direct connectors" in a particular joint-line movement. The section, however, provided an exception from this requirement until January 1, 1984, with regard to collective activity to cover inflationary cost increases. Congress also gave the Commission discretionary power to suspend the January 1, 1984, implementation of the direct connector provision to this activity if it found that implementation was not shown to be feasible.

In Ex Parte No. 447, petitioning railroads argued that the direct connector restriction impaired their recovery of inflationary costs, and, accordingly, its application was infeasible. Petitioners asked for a 3-year delay. The Commission denied that request and was upheld on appeal.

The Staggers Act required numerous other changes to rate bureau procedures. We have issued a number of decisions addressing those requirements, Due to their complexity, the process of reviewing rail rate bureau agreements for compliance is not yet complete.

Section 220.—This section deals with long and short haul transportation. The Commission adopted rules implementing this section in 1983, in Ex Parte No. 346 (Sub-No. 3) Rail General Exemption Authority—Long and Short Haul Transportation, 367 I.C.C. 234 (1983).

Section 221.—This section made it easier for parties to receive Commission authorization to enter, through construction or extension of lines, into a new market. It also gave the Commission discretion as to the imposition of employee protection conditions.

Section 222.—This section permits carriers to fulfill contract commitments prior to responding to reasonable requests for service without being found in violation of their common carrier obligation.

Section 223.—This section gave the Commission the authority to require railroads to enter into reciprocal switching agreements where it finds such agreements to be practicable and in the public interest. As discussed above in connection with section 207, the Commission has recently addressed this and a number of related competitive access issues in the context of Ex Parte No. 445 (Sub-No. 1).

Section 224.—This section deals with car service compensation. It also repealed an earlier provision which allowed the Commission to impose incentive per diem rates.

Section 225.—This section deals with car utilization and allows carriers to establish premium rates for special services requested by shippers.

Section 226.—This section limited the Commission's authority to issue car service orders to instances where it is found that a nationwide or broad regional emergency exists.

Section 227.—This section provided for employee protection in transactions involving transfers or the operation of or over a debtor's lines by another entity under the Bankruptcy Act of 1978.

Section 228.—This section significantly modified the law as to mergers and consolidations. Section 228 made three major changes: (1) Commission practice in considering competitive impacts in consolidation proceedings involving two or more Class I railroads was codified; (2) consolidations not involving two or more Class I carriers must be approved unless they present irremediable competitive problems; and (3) a new category was established for minor rail mergers and consolidations with an expedited schedule for the receipt of evidence and the issuance of a final decision that does not provide an opportunity for the filing of inconsistent applications. These and other changes were implemented by the Commission in Ex Parte No. 282 (Sub-No. 3) and Ex Parte No. 282 (Sub-No. 8). Section 228 also affected the decisional factors to be considered in consolidation cases, and the Commission issued a revised rail consolidation policy statement. Ex Parte No. 282 (Sub-No. 6).

Another key decision in the rail consolidation area dealt with the Commission's attempt to address the problem of traffic protective conditions. Ex Parte No. 282 (Sub-No. 5). This proceeding was instituted in July 1980, and was decided after consideration of the fundamental changes to rail regulation made by the Staggers Act. The Commission had previously imposed traffic protective conditions in an attempt to lessen the impact of consolidations on non-applicant railroads and the public and to preserve pre-existing joint rates and rate relationships. In its decision, the Commission found that traffic protective conditions imposed in past rail consolidation proceedings were anticompetitive and contrary to the public interest, and would be revoked unless the parties demonstrated a public interest in continuing them. The

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decision also stated that these conditions would not be imposed in the future. The decision pointed out the emphasis in the Staggers Act on the need for changes in rail carrier rate-setting practices, and encouraged carriers to examine existing rates and routing.

In *Detroit, Toledo and Ironton R.R. Co.* v. *ICC*. 725 F.2d 47 (6th Cir. 1984), the Court reversed and remanded the portion of the decision that revoked conditions previously imposed. The Court stated that these conditions could be revoked only through consideration of the criteria in 49 U.S.C. 11344(b)(1) in individual hearings for each merger. Such proceedings have been completed for four previous mergers, and a decision revoking the conditions in each case was issued on July 2, 1985. Proceedings are ongoing for conditions imposed in a number of other previous mergers.

Finally, section 228 changed the law regarding railroad or railroad-affiliate acquisitions of motor carriers. In Ex Parte No. 438, the Commission looked at that issue, especially the so-called "special circumstances" doctrine. This doctrine reflects a presumption against rail and rail-affiliate acquisitions of motor carriers. Prior to the Staggers Act, the statute permitted the Commission to approve acquisitions that would result in coordinated and economical transportation service, but at the same time, the Commission was to keep competing transportation modes from taking control of the then fledgling motor carrier industry. As a result, the Commission conditioned such acquisitions on the motor carrier service being confined to that auxiliary and supplemental to rail service. Based on the Staggers Act changes, and the economic realities present today, the Commission, in Ex Parte No. 438, decided to eliminate the "special circumstances" doctrine as a presumption. Instead, rail and rail-affiliate acquisitions of motor carriers are to be examined on a case-by-case basis, emphasizing the competitive impact of the proposal.

Set forth below is a brief overview of merger and consolidation activity since enactment of section 228.

The first consolidation involving two or more Class I railroads to be decided after the enactment of Staggers was the acquisition of control by Norfolk Southern Corporation of Norfolk and Western Railway Company and its subsidiary companies, and of Southern Railway Company and its consolidated companies. In the decision authorizing the transaction, *Norfolk Southern Corp.—Control—Norfolk & Ry. Co.* 366 I.C.C. 171 (1982), the Commission undertook an extensive analysis of the competitive impacts of the transaction.

The Commission subsequently considered two other consolidations involving Class I railroads under section 228. In *Guilford Transp. Industries, Inc.—Control—B&M Corp.*, 366 I.C.C. 292 (1982), the Commission approved the acquisition of control of the Boston and Maine Corporation and its subsidiaries and leased lines by Guilford Transportation Industries, Inc., (GTI) a non-carrier that controlled the Maine Central Railroad Company. In *Guilford Transp. Industries Inc.—Control—D&H Ry. Co.* 366 I.C.C. 396 (1982), the Commission approved the acquisition of control of Delaware and Hudson Railway Company by GTI.

In September 1982, the Commission approved the merger of the Union Pacific, Missouri Pacific and Western Pacific railroads.[8]

This resulted in a single western system consisting of about 21,000 miles of rail, from the West Coast to the major gateways of Salt Lake City, Omaha, Kansas City, St. Louis, Chicago, Dallas/Ft. Worth, El Paso and New Orleans. The application was filed prior to the effective date of the Staggers Act, but because the Act merely cofidied our traditional approach to analyzing mergers, we, in effect, considered the application under the Staggers Act criteria. The Commission thoroughly examined the effects on competition of this significant merger, and imposed conditions that enable other railroads to provide competition in areas where we foresaw adverse effects as a result of the merger.

A proposed consolidation of two other Class I railroads is also currently before the Commission. In Finance Docket No. 30400, Santa Fe Southern Pacific Corporation, a non-carrier that controls the Atchison, Topeka and Santa Fe Railway Company, is seeking authority to acquire control of Southern Pacific Transportation Company.

The section 228 criteria were also used in a major case involving proposals for reorganization and acquisition of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, (MILW). In Finance Docket No. 28640 (Sub-No. 9), et al., reorganization plans were filed under former section 77 of the Bankrupcy Act. Acquisition proposals were filed under section 5 of the Milwaukee Railroad Restructuring Act, 45 U.S.C. 904. In a decision served September 11, 1984, the Commission approved the acquisition proposal of Soo Line Railroad Company (Soo) but did not reach a majority decision to approve an alternative proposal of Chicago and North Western Transportation Company (CNW). The Commission stated that had CNW's proposals been approved, conditions would have been required to ameliorate anticompetitive effects that would have resulted.

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[8] *Union Pacific—Control—Missouri Pacific; Western Pacific*, 366 I.C.C. 459 (1982), *aff'd. per curiam, Southern Pacific Transportation Company* v. *Interstate Commerce Commission* 736 F.2d 708 (D.C. Cir. 1984), cert. denied, 105, S.Ct. 1171.

The Commission was then requested by the MILW's Reorganization Court to consider a revised CNW acquisition proposal and compare it with Soo's proposal that was approved previously. The supplemental decision, served January 11, 1985 approved CNW's proposal, but the Soo proposal was determined to be preferable primarily because it appeared more likely to result in more extensive intramodal competition. Ultimately, the Reorganization Court authorized the Soo's acquisition proposal.

The Staggers Act provisions governing consolidations other than those involving two or more Class I railroads were applied in two recent intermodal proceedings. In *CSX Corporation-Control-American Commercial Lines, Inc.*,—I.C.C. 2d—(1984), the Commission approved an application by CSX Corporation, a non-carrier holding company with subsidiaries engaged in railroad operations, to control American Commercial Lines, Inc., a non-carrier holding company with subsidiaries engaged in water carrier operations. In *Norfolk Southern Corporation-Control-North American Van Lines, Inc.*, —I.C.C. 2d—(decision served May 13, 1985), the Commission authorized the acquisition of control of North American Van Lines, Inc., a large motor carrier of household goods and general freight, by Norfolk Southern Corporation, a non-carrier holding company that already controlled several Class I railroads. This decision also provided the first application of the Commission's liberalized rail/motor acquisition standards established in Ex Parte No. 438.

As noted above, section 228 also established a new category of rail consolidations dealing with transactions that did not involve two or more Class I railroads or matters of regional or national transportation significance. Under this section, codified at 49 U.S.C. 11345(d), inconsistent applications are not permitted. Thus, the determination that a transaction is governed by section 11345(d) is significant for those who would seek to file competing applications. This issue arose in Finance Docket No. 30387, *Canadian National Railway Company and Canadian Pacific Limited—Acquisition—Interests of Consolidate Rail Corporation in Canada Southern Railway Company and Detroit River Tunnel Company*. This proceeding involved an application by two Canadian railroads (Canadian National and Canadian Pacific) seeking approval to acquire the interest of Consolidated Rail Corporation in the stock and properties of Canada Southern Railway Company, Detroit River Tunnel Company, and the Niagara River Bridge Company. In an embraced proceeding, the applicant also sought approval for the acquisition of certain trackage rights over Conrail lines in Michigan. In a decision served February 15, 1984, the application was accepted as a minor transaction. This determination precluded the filing of an inconsistent application by a syndicate seeking to acquire the properties. The application was approved in a decision served September 4, 1984.

Section 229.—This section is known as the savings provision. It allowed shippers, for a limited period after enactment of the Act, to challenge rates in existence at the time the Act became effective. In the absence of a successful complaint, the rates were conclusively presumed to be reasonable and became established as base rates over which we have no jurisdiction. Shippers had until March 30, 1981 to complain that existing rates were unreasonably high, and 864 complaints were filed under this provision.

To organize the processing of these complaints, the Commission developed procedures different from those typically used. First, the railroad defendants were required to file answers and the Commission urged both sides to submit joint responses. We specifically requested information with regard to whether settlement was contemplated, whether the Commission's offices would be useful in bringing about settlement, whether oral hearing, cross-examination, or other procedural tools would be necessary in particular cases, and whether certain proceedings could and should be considered. Second, we announced our intention to handle those cases that did proceed to formal adjudication in two stages. The first stage would address solely the issue of market dominance to save time and expense when we did not have jurisdiction to review that rate. Thus, only if market dominance were established would the Commission then proceed to the second stage to take evidence and analyze the reasonableness of the challenged rate.

On October 29, 1981, the Commission's Chief Administrative Law Judge held a docket management conference to refine further the procedures for handling these complaints. Since that date, a number of informal docket management conferences have been held, and regular docket management reports have been issued. The sixteenth status report was served on August 8, 1985. Most complaints have either been settled, dismissed, or decided. Precise information concerning all pending section 229 cases is outlined in an updated status report which is attached as Appendix III.

TITLE III—RAILROAD COST DETERMINATIONS

This title provides for the creation of a Railroad Accounting Principles Board (RAPB) to establish principles for determining economically accurate railroad costs directly and indirectly associated with particular movements of goods. The Board was to establish these principles within two years of enactment of the Staggers Act. Once established, the Commission is to promulgate rules to implement and enforce them. The RAPB was not funded at the time Staggers was passed. However, in 1984 Congress passed legislation funding the RAPB for fiscal 1985.

On November 13, 1984, the Commission issued a decision to hold Ex Parte No. 431, Adoption of the Uniform Railroad Costing System for Determining Variable Costs for Purposes of Surcharge and Jurisdiction Threshold Calculations, in abeyance until the Railroad Accounting Principles Board has had the opportunity to review URCS. This proceeding was opened in 1982 to adopt URCS for limited purposes. The URCS rulemaking is currently under review by the RAPB.

TITLE IV—RAILROAD MODERNIZATION ASSISTANCE

Section 401 of this title establishes a new feeder railroad development program, which gives shippers and interested persons (other than Class I or II railroads) the opportunity to acquire a rail line where service is inadequate and the sale would not adversely affect the carrier, or where the railroad had indicated the possible abandonment of the line on its system diagram map. For the first 3 years after the Staggers Act became effective, this provision was limited to lines carrying less than 3,000,000 gross ton-miles of traffic per mile in the preceding year. Thereafter, any rail line could be acquired under this provision.

The Commission implemented this provision in Ex Parte No. 395, Feeder Railroad Development Program. Our rules require offerors to submit evidence that they are capable of paying the Constitutional minimum value of the line and of providing adequate service for 3 years. The rules are designed to encourage privately-negotiated agreements. We will set the purchase price for those line only if the parties fail to agree.

Thereafter, it became apparent that this provision allowed affected rail carriers an opportunity to seek the dismissal of feeder notices by filing abandonment applications or amending system diagram maps before feeder applications were filed. Accordingly, in Ex Parte No. 395 (Sub-No. 1), Feeder Line Development Program, we eliminated the prior notice period and established tight regulatory time frames, including a final Commission cesision within 130 days of the filing of the application. These regulations require feeder and abandonment applications to be processed concurrently, giving feeder applicants an opportunity to acquire lines prior to abandonment or downgrading.

Section 402 of Title IV established new time limits for considering abandonment and discontinuance of service applications. Unopposed applications are to be granted within 45 days. The Commission must process and decide opposed cases within nine months. The Commission implemented this provision in Ex Parte No. 274 (Sub-No. 6), Abandonments of Rail Line and Discontinuance of Service. The most significant changes caused by these rules are in: (1) the time frames governing the processing of abandonment and discontinuance applications; (2) the elimination of the automatic right to appeal initial decisions; and (3) the procedures for making offers of financial assistance either to subsidize continued operations or to purchase the rail line being abandoned.

The Commission has issued numerous other decisions and is considering other changes in its abandonment regulations. These are listed and discussed briefly in Appeidix I.

Thank you for this opportunity to comment. I will be pleased to respond to any questions you may have.

Senator PRESSLER [presiding]. Thank you very much.

Mr. STRENIO. Senator, I have a short statement, if I might.

Senator PRESSLER. All right.

Mr. STRENIO. I thank you for the opportunity to testify before you this morning on the subject of the ICC's implementation of the

Staggers Rail Act. This is a matter of some controversy and great importance. In order to save time, I will summarize my prepared statement.

In the interest of truth in labeling, I must acknowledge that my personal perspective on the ICC's handling of the Staggers Act——

Senator Rockefeller. Mr. Chairman, with all due respect, I am not aware who our witness is.

Senator Pressler. All right. Identify yourself.

Mr. Strenio. Senator, I am Commissioner Strenio at the Interstate Commerce Commission.

Senator Rockefeller. Thank you.

Senator Long. Incidentally, Mr. Chairman, this raises a question that I brought up at a meeting a couple of days ago. This committee should ensure that all witnesses have name tags in front of them, as we do in the Finance Committee. You see, there is one for the Chairman, Mr. Taylor, which I think is fine, but we need one for the others so that each member can see who is testifying.

Senator Ford. Mr. Chairman, I don't even see him on the witness list as such.

Senator Long. Well, he is a member of the Commission, and an able member——

Senator Ford. Only for a short period of time.

Mr. Strenio. Yes, sir.

Senator Long. I hope he gets a promotion. In any event, we ought to identify the witnesses.

Senator Pressler. Well, as acting chairman, I am going to issue an order that from now on, all witnesses have names in front of them. How is that?

Senator Long. Thank you.

Senator Pressler. That is exercising my power.

Commissioner Strenio, we will hear from you, if you can summarize.

Mr. Strenio. Thank you.

Thank you, Senator Long. As junior member, I am used to doing without, so I appreciate your interest.

As Senator Ford has pointed out, my experience with the Staggers Act is limited to the 1 year during which I have been a Commissioner. Nonetheless, I do want to briefly highlight some important decisions at the ICC since September 1984. In doing so, I do not mean to slight the many other actions that the Commission has concurrently taken that promote the goals of the Staggers Act and have been generally acclaimed.

Taken together, these developments reveal that the Commission has traveled very far indeed in its odyssey, searching for fair and efficient solutions to a host of very difficult issues. In the past year, the Commission has completed work in four particularly noteworthy rail proceedings, all of which benefit shippers.

In Ex parte No. 456, the Commission provided a forum for all interested parties, shippers and railroads alike, to discuss their views of how the Staggers Act was being implemented and to seek common ground in proposing modifications. In fact, the Commission has already in essence ratified two proposed agreements that arose directly from the Ex parte No. 456 process and that reflected a negotiated compromise between shipper and railroad groups.

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In Ex parte No. 320, the Commission decided to substantially shift the burden of proof in market dominance determinations. The Commission now places the burden on the railroads, rather than the shippers, of showing the existence of effective product or geographic competition.

In Ex parte No. 445, the Commission adopted rules to govern competitive access questions. These rules reduced the burdens on shippers and competing railroads, while imposing correspondingly heavier burdens on defendant railroads.

Finally, in Ex parte No. 347, the Commission made significant changes in its interim maximum coal rate guidelines that are much more favorable from a shipper's perspective.

Such remarkable change in such a short period of time should shatter any remaining perception that the Commission is unable or unwilling to fine-tune its implementation of the Staggers Act. Does this flurry of activity mean the Commission has completed its work or has attained perfection? My answer is, most emphatically, no. We still have a long way to go before the Commission can conclude that it has done all that it can and should do to properly balance the views of consumers, shippers and railroads in the public interest.

My point is not that the Commission has finished its journey, but only that we are moving at a good clip and in the right direction. Looking toward the future, I am confident that the Commission will continue to make progress as its understanding and implementation of the Staggers Act evolves. I hope the Commission will be given the chance to further refine its Staggers Act role.

Last week I had the pleasure of visiting with members of the Western Coal Traffic League at their annual fall meeting. A question that I was asked there struck me as going to the heart of the question before you today. One of the individuals in attendance recited a litany of ICC actions that had disappointed him and then asked me why he should now decide to trust the ICC.

My answer then, and now, is that especially in light of the achievements of the ICC in Ex partes Nos. 456, 320, 445, and 347, the Commission has earned a chance to continue implementing the Staggers Act and to allow the reforms already promulgated to work.

We may all differ on exactly how far along the ICC is on its journey to complete the work begun by the Staggers Act and on exactly where the finish line is. But I think there can be no doubt that the Commission has made appreciable forward progress. Your continued oversight and guidance will help provide sure footing for the Commission as it continues along this challenging path.

Thank you.

STATEMENT OF ANDREW J. STRENIO, JR., COMMISSIONER, INTERSTATE COMMERCE COMMISSION

Mr. Chairman and Members of the Subcommittee: Thank you for the opportunity to testify before you this morning on the subject of the ICC's implementation of the Staggers Rail Act. This is a controversial matter of great importance.

In the interest of "truth-in-lending," I must acknowledge that my personal perspective on the ICC's handling of the Staggers Act is limited to my one year's service as a commissioner. Nonetheless, I would like to highlight some important decisions at the ICC since September 1984. In doing so, I do not mean to slight the many

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other actions that the Commission has concurrently taken that promote the goals of the Staggers Act and have been generally acclaimed. Taken together, these developments reveal that the Commission has traveled very far indeed in its odyssey, searching for fair and efficient solutions to a host of very difficult issues.

In the past year, the Commission has completed work in four particularly noteworthy rail proceedings, all of which work to the benefit of shippers:

In Ex Parte 456, the Commission provided a forum for all interested parties—shippers and railroads alike—to discuss their views of how the Staggers Act was being implemented and to seek common ground in proposing modifications. In fact, the Commission has already in essence "ratified" two proposed agreements that arose directly from the Ex Parte 456 process and that reflected a negotiated compromise between shipper and railroad groups (i.e., the Ex Parte 320 and 445 proposals). At least one more such agreement (covering contract disclosure) is likely to come before us soon.

In Ex Parte 320, the Commission decided to substantially shift the burden of proof for two aspects of the market dominance determinations. The Commission now places the burden on the railroads, rather than the shippers, of showing the existence of effective product or geographic competition.

In Ex Parte 445, the Commission adopted rules to govern competitive access questions. These rules reduce the burden on shippers and competing railroads, while imposing correspondingly heavier burdens on defendant railroads.

Finally, in Ex Parte 347, the Commission made significant changes in its interim maximum coal rate guidelines that are much more favorable for a complaining shipper.

Such remarkable change in such a short period of time should shatter for good any remaining perception that the Commission is unable or unwilling to fine-tune its implementation of the Staggers Act.

The Ex Parte 347, 320 and 445 proceedings were all quite complex and thus warrant further elaboration:

EX PARTE NO. 347 (SUB-NO. 1), COAL RATE GUIDELINES—NATIONWIDE

This case responded to the Congressional directive that the Commission determines maximum rate reasonableness in those situations where shippers need protection from the abuse of market power by rail carriers. We set new guidelines that respond to concerns raised by various coal shippers and that reflects a determined Commission effort to strike a fair balance in the public interest.

The Commission made important substantive changes that work in favor of shippers. Three changes in particular deserve mention:

The Commission adopted a long-run marginal cost standard for use in evaluation allegations of carrier management inefficiencies. Reflecting the important Long-Cannon Amendment, this change provides shippers with a safeguard against being forced to pay any needless costs caused by mismanagement on the part of a carrier.

The Commission amended its "stand-alone cost" guideline to make clear that a complaining shipper is not limited to "constructing" (hypothetically) a single-shipper railroad. The ability to present ideal groupings should provide a substantial advantage for any shippers that decide to employ this innovative technique.

The Commission reversed an earlier decision that would have created a rebuttable presumption for annual rate increases of up to 15 percent. Instead, the Commission decided that all increases that are found otherwise reasonable would still be subject to case-by-case review to determine whether carriers should be forced to phase in the new rates in order to provide shippers with extra time to adjust.

The Commission had been struggling for years to develop an analytically sound and legally defensible approach to maximum rate reasonableness—an approach that properly balances protection for shippers subject to the potential abuse of market power with the needs of carriers for income sufficient to attract adequate capital. The coal rate guidelines provide a basis for doing just that. The new guidelines afford shippers real protections against carrier inefficiency or abuse of market power. Yet they also preserve considerable pricing flexibility for carriers so that the rail system can remain viable. The public interest is thereby served to the extent that shippers are protected while carriers can attract the capital needed to maintain quality service to shippers and the public over the long term.

EX PARTE NO. 320 (SUB-NO. 3), PRODUCT AND GEOGRAPHIC COMPETITION

The decision in this proceeding responded to shippers' concerns about situations in which they face a "market-dominant" railroad. Here the Commission approved changes in the way it determines whether traffic is subject to market dominance. In

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particular, we shifted the burden of proof of the existence of effective product or geographic competition from shippers to railroads. The effect will be to facilitate shippers' efforts to gain the protections that a showing of market dominance provides.

The Commission's decision adopted an agreement negotiated by interested parties and further demonstrates our strong and continuing commitment to achieving a poroper balance in the interest of the public and the affected parties.

EX PARTE NO. 445 (SUB-NO. 1), INTRAMODAL RAIL COMPETITION

In this proceeding, the Commission responded to complaints of some shippers and carriers about a lack of access to certain railroad lines. We substantially liberalized the conditions under which we wil grant competitive access to shippers and competing carriers.

The Commission adopted virtually in its entirety the National Industrial Transportation League—Chemical Manufacturers Association—Association of American Ralroads (NITL-CMA-AAR) Agreement as presented to us. This significant change in the way the Commission will determine competitive access issues in the future clearly demonstrates the Commission's deep—and unanimous—commitment to a fair balancing of the views of diverse groups in reaching public interest determinations.

The Commission also adopted several changes proposed by the Railroads Against Monopoly (RAM) that provide additional benefits to complaining shippers and railroads.

The Commission gave serious consideration to a host of other proposals. While we ultimately could not adopt them all, the exercise gave the Commission greater insight into the concerns of the groups presenting the proposals. All the groups participating in Ex Parte No. 445 received a respectful and attentive hearing even if their solutions were not adopted.

These three decisions demonstrate the Commission's eagerness to respond sympathetically to shipper concerns. We adopted new maximum rate guidelines for coal in Ex Parte No. 347 that are more favorable to shippers. We shifted a much heavier burden of proof onto railroads—and off the shoulders of shippers—in market dominance determinations by our decision in Ex Parte No. 320. And we adopted rules that enhance the ability of shippers and carriers to gain competitive access in Ex Parte No. 445.

Does this flurry of activity in the past year mean the Commission has completed its work, or has attained perfection? My answer is most emphatically, "No!" We still have a long way to go before the Commission can conclude that it has done all that it can and should to properly balance the views of consumers, shippers, and railroads in the public interest. My point is not that the Commission has finished its journey, but only that we are moving at a good clip in the right direction.

Looking toward the future, I am confident that the Commission will continue to make progress as its understanding and implementation of the Staggers Act evolves. I hope the Commission will be given the chance to further refine its Staggers Act role.

Last week I had the pleasure of visiting with members of the Western Coal Traffic League at their Annual Fall meeting. A question I was asked there struck me as going to the heart of the question before you today. One of the individuals in attendance recited a litany of ICC actions that had disappointed him, and then asked me why he should now decide to trust the ICC. My answer then and now is that—especially in light of the achievements of the ICC in Ex Parte Nos. 456, 320, 445, and 347—the Commission has earned a chance to continue implementing the Staggers Act and to allow the reforms already promulgated to work.

We may all differ on exactly how far along the ICC is on its journey to complete the work begun by the Staggers Act, and on exactly where the finish line is. But I think that there can be no doubt that the Commission has made appreciable forward progress. Your continued oversight and guidance will help provide sure footing for the Commission as it continues along this challenging path. Thank you.

OPENING STATEMENT BY SENATOR PRESSLER

Senator **Pressler**. Thank you very much.

I am now prepared to give my opening statement, and two additional Senators have arrived who may have statements. Mine is fairly brief: I will summarize it and after the statements we will hear from Congressman Tauzin.

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In the past, I have consistently opposed transportation deregulation. I voted against trucking deregulation, against bus deregulation, and against the Staggers Act which we are reviewing today. However, at least in the railroad area, I am not absolutely convinced that we want to begin turning the clock back to pre-1980. Railroad deregulation has worked, and to a certain degree, worked quite well in revitalizing this extremely important industry.

Railroads have made a commendable recovery since the disastrous days of the late 1970's. The industry's return on investment has increased from 2.9 percent in 1979 to 5.9 percent in 1984. Freight revenue has remained fairly constant, despite the recent recession. And, in general, rates have remained fairly reasonable in most cases.

So, for the most part, I am not here today to condemn railroad deregulation. To the contrary, I would say that on a national scale, it has worked quite well.

But I do want to stress the point that rural States, such as South Dakota, still have very real and serious rail problems. Abandonments continue to increase. We see very little investment in physical plant or maintenance of our existing lines. The prevailing corporate philosophy for the lighter density lines seem to be "Run the trains until the tracks run out and then abandon." We have experienced the loss of many miles of rail line in South Dakota since 1980, and we continue to face serious problems in holding on to the few lines we have left.

I am not blaming these problems on the Staggers Act, but they do need to be addressed. They were not adequately addressed when it was passed in 1980, but I think we can still correct them within the framework of Staggers.

Deregulation gave the industry considerable market flexibility and the dynamics of that industry have changed substantially. Mergers proliferate. Since the passage of Staggers, the number of major railroads has declined from 12 to 8, and there are 2 more major rail mergers pending today.

As major railroads continue to consolidate, many of the marginal lines become increasingly threatened. Macrodecisions made in corporate board rooms naturally focus on main line operations. The point is that I am afraid lighter density lines, such as those in South Dakota, receive little if any attention at the top management levels. As a consequence, they are often abandoned before the papers are ever filed.

We are working to overcome that problem in South Dakota. With the cooperation of the Chicago & North Western and others, we have met with limited success. Much work remains, but we have gone a long way to ensure long-term viability of our light density lines. We cannot afford to lose them. Elimination of service often translates into increased difficulty and cost for rural farmers and manufacturers to get their products to market. As a result, their products are worth less.

One of the things I want to focus on today is what steps we can take to help preserve and strengthen light density lines. We are not looking for major new subsidy programs or Government handouts. What we do need is to promote effective operation and utilization of these branch lines by encouraging cooperation rather than

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confrontation in these situations. One possible answer may be the establishment of short lines or regional carriers on light density lines before larger railroads abandon them or allow them to wither on the vine. Now is the time to start.

We recently won two major abandonment fights in my State and in North Dakota, but the victories will be short lived unless we can address the long-term problems. We need to begin planning rather than reacting.

In South Dakota, we recently held a conference with rail experts and Government officials to get that preservation process started. I am pleased to report that the Chicago & North Western, one of the primary freight lines in South Dakota, has been working hard to help save and improve these light density lines. I am interested in expanding these types of creative solutions by establishing and encouraging a national policy toward this end.

I want to address the question of what we can do within the framework of Staggers to encourage activity like Chicago & North Western's on an industrywide basis. What statutory or administrative steps can we take to encourage solid, viable short line or regional operations; to address labor protection and labor cost issues; encourage shipper and community support; develop financial arrangements that will help buyers overcome capital investment shortfalls? How can we encourage cooperation instead of confrontation among the railroads, shippers, labor, and affected communities? These are all issues that I plan to discuss today and will continue to explore after these hearings are concluded.

Another concern I hope the witnesses will address is the effect of deregulation on rate levels. Current evidence seems to indicate that rates have not increased exorbitantly in the past 5 years. But I want to address the potential for future rate increases and their effects on shippers, especially as the industry becomes increasingly consolidated.

Mergers and abandonments will certainly create more captive shippers who are forced to rely upon one rail line. Their are statutes and standards that limit the amount by which railroads can raise their shipping rates. But are those guidelines adequate to meet the future needs of shippers, carriers, and consumers, given the evolution taking place in the rail industry today?

I want to thank the witnesses for being here today, and I look forward to hearing their thoughts and comments on the issues I have raised.

I will now call on any of my colleagues who have arrived, if they have opening statements they wish to give at this time.

Senator **Rockefeller**. Mr. Chairman, I don't want to hold up the Congressman if he is here and wants to testify.

Senator **Pressler**. Good. Congressman Tauzin, do you want to move to the witness table? If you want, you can make your statement from right there.

Senator **Rockefeller**. I want to make a statement, but I don't want to hold up the Congressman.

Mr. **Tauzin**. Go ahead and make your statement, Senator.

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OPENING STATEMENT BY SENATOR ROCKEFELLER

Senator **Rockefeller**. All right, thank you.

Mr. Chairman, when I go back to West Virginia and I travel the rugged terrain of my home State and I talk to the coal miners, both those of whom are working and the many who are not, these folks ask me some pretty tough and practical questions. They ask me why they don't have jobs and why a State that has such an abundant supply of natural resources, particularly coal, has such a difficult time getting its coal to market and getting its coal to port and selling its coal overseas where a lot of our coal does in fact go.

And they ask me why some of the major U.S. utilities are buying or are planning to buy increasing amounts of coal from Colombia and Canada and even South Africa. They ask me why utilities have been regularly increasing the purchase of electricity from Canada. They ask me why they can't get their coal to be competitive to all but a handful of the powerplants run by the Tennessee Valley Authority. They ask me why someone in Washington isn't doing something concrete to help with all of this.

Obviously these are tough questions, and the answers are not easy. They do not lie in a single area. They lie in areas of trade, strength of the dollar, and also transportation.

Mr. Chairman, the miners of West Virginia are the bedrock that in part has made this country. They know, as should we, that while part of the explanation for their plight is a complex one, there is one part of the problem—namely, rail transportation rates—which is not complex and which can be addressed.

They have not, and neither should we be fooled by the crocodile tears of the railroads.

Mr. Chairman, in my view, we have been made to play the fool, all of us, by the regulatory cynicism and gymnastics at the Interstate Commerce Commission over the last 5 years. We in coal States have watched and waited for the balance of captive shipper and rail interests to reach some sort of an even keel.

But with every new pronouncement, with every new misinterpretation of the congressional intent of the Staggers Rail Act, our hopes have faded into disappointment and disbelief.

Mr. Chairman, I talked 2 days ago with Congressman Harley Staggers, Sr., the author, with the name on the bill, who expressed disappointment to me about the interpretation by the Interstate Commerce Commission of market dominance, captive shippers, and other issues that have come into play in determining what was meant by deregulating the railroads, to help make them profitable, while helping those coal mines and coal shippers on the end of single rail lines.

Under the crazy formulation of revenue adequacy at the ICC, no railroad—no railroad—has been found to be revenue-adequate. That, I guess, means solvent, rich, something. This is so, even though as an industry, the railroads appear to have one of the best cash hordes around from the number of acquisitions they have made or have ongoing.

And without a finding of revenue adequacy, you rarely even get to the question of whether the rate is unreasonable. You can't get to the unreasonableness until you get to the revenue adequacy

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part. The rate at which the captive producer ships his coal to port or the utility ships its coal to the plant might be found unreasonable if you can prove that it exceeds the total cost—that is, the so-called stand-alone cost of building an alternate transportation network—and that is your only shot.

Mr. Chairman, by my comments and by questions which I hope to ask, it is obvious that I support the legislative reform of the Staggers Rail Act. However, West Virginia coal producers who regularly sell at the breakeven point can ill-afford to continue in the present system. They must begin to rebuild their export markets now. They must stem the tide of increasing coal imports now. They must get meaningful rail rate reductions of $5, $6, $7, $8 now.

They do not, we do not, I do not seek reregulation of the railroads, but they do seek basic fairness. They do seek an even-handed interpretation of the Staggers Rail Act at the ICC, the Staggers Rail Act as it was passed, as it was intended to be by the Congress.

I think it is time, quite frankly, that we move from oversight hearings, which this is, to legislative hearings, which this is not—and get a bill out on the Senate floor for a vote. I am committed to restoring the balance of shipper and rail interests. Balance, I say—balance—and we will work hard with the members of this committee to achieve that goal.

Mr. Chairman, in conclusion, I wish to say that I had submitted to this committee two names, Dwight Keating and Barbara Warner, both of whom represent mid-sized and small coal mines in West Virginia. They had wanted to come here and testify and talk about the problems that the smaller people in this business are having with respect to rail rates. They were not invited to come. And so I did ask for their testimony, and I would ask your permission to submit their testimony as part of the record.

Senator **Pressler**. Without objection.

I would be delighted to hear them. I am not chairman of the subcommittee, so I know nothing about that decision. Senator Packwood is out of the room. When he comes back, we will ask him that question. But I would be delighted to hear them.

OPENING STATEMENT BY SENATOR FORD

Senator **Ford**. Mr. Chairman, I worked very hard to put some remarks together for this oversight hearing, but on the way to the hearing I searched and discovered that I had misplaced my remarks. Trying to put something together here or recall is difficult, and after listening to my distinguished colleague from West Virginia, I know who found my remarks.

Jay, you delivered them just as I would have.

I concur with what he has said.

Let me say, Mr. Chairman, that my problem with the Staggers Act stems more from the implementation by the Interstate Commerce Commission. The bottom line—and I say this looking at you at the witness table, and you cannot find anything different in the record—is that no coal shipper has won a case at the ICC, and with every decision you make, it seems that the ICC makes it even impossible for a shipper to win a case.

Senator **Long**. Nor has a consumer won a case at the ICC.

Senator **Ford**. There you go. So you just keep right on going. I'm sorry to see two of the Commissioners go. I wish they would all go.

My primary concern with the implementation has been the flawed revenue adequacy test and the burdensome and unrealistic coal rate reasonableness standard now being used by the ICC.

You know, it is very strange that you say none of the railroads are revenue-adequate, when just a few weeks ago, the Secretary of Transportation was here and said the Norfolk Southern ought to buy Conrail because it had "deep pockets."

Under the Staggers Act, whether or not a railroad has achieved revenue adequacy is of great concern to captive shippers. If a railroad has achieved revenue adequacy, the ICC has indicated that some sort of constraint will be placed on rates charged to captive shippers. If the ICC determines that a railroad is not yet revenue adequate, then the railroad is granted greater leeway in setting the rates it charges to captive shippers. Under the revenue adequacy test adopted by the ICC, none of our Nation's major railroads are considered to be revenue adequate. This situtation defies logic and common sense when several months ago in this very room, the Secretary of Transportation tried to convince the members of this committee that Norfolk Southern should be allowed to purchase Conrail due to Norfolk Southern's deep pockets. Norfolk Southern is not considered revenue adequate by the ICC. Clearly, we must correct the revenue adequacy test used by the ICC.

I really did not think that the ICC could top their revenue adequacy test, but the coal rate reasonableness standard that was adopted recently by the ICC provides that no rate is unreasonable unless a group of shippers could build and operate their own transportation alternative more cheaply. This concept is called "stand alone cost" and by the ICC's own admission, no other regulatory body in the United States uses this concept for determining reasonableness of rates. Let me apply the same concept to another rate—say a consumer is unhappy with his telephone bill and appeals to the State public service commission. I can imagine the consumer's reaction if he were told the cap on his rates would be what it would cost for him to build his own telephone system.

The Senate Commerce Committee has the responsibility to assure that the laws drafted by this committee and enacted by the Congress are properly and fairly implemented. We have held oversight hearings before, and many members of this committee have discussed our concerns with the Commissioners at the ICC. I have given up hope with the ICC. I had hoped that the ICC would come into this hearing today with news which would delight me regarding captive shippers. The market dominance decision of July 31, 1985 was the first decision in 5 years that addressed any of the concerns of captive shippers, but I haven't seen anything since. And still today, no shipper has won a case at the ICC, and there is no propsect of a shipper ever winning a case.

I look forward to asking this panel some questions. I hope you don't cut us off too quickly, so that if our time runs out we will have an opportunity to visit with them on the second round.

Senator **Pressler**. I have never cut my friend from Kentucky off from anything.

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Senator **Ford**. I don't believe that you would, but I wanted to put my concerns in the record.

Senator **Long**. Mr. Chairman, I looked at the order in which the witnesses will testify, and I could not understand why the hearings were organized in this fashion until I reviewed my previous correspondence with the committee chairman. In this regard, I think that we ought to recognize for the record that 6 of us on this committee—there is a total of about 13 cosponsors, but 6 of us are members of the committee, more than one-third of the members of the committee—have been seeking a hearing on this subject of abuse of what we believe the Staggers Act should be construed to be.

We introduced our bill on February 20, and Chairman Danforth wrote us a letter on July 17, saying that in due course these oversight hearings would be held.

And I guess that explains why we don't have the opportunity to have our witnesses testify to the abuses first and let those on the Commission and others undertake to explain their position second. I have always thought that in presenting a case, the plaintiff had the right to present his case first, and then the defense could come along behind that.

Now, I would prefer not to ask my questions to those on the Commission and those in the administrative branch, or even Mr. Dempsey with the Association of Railroads, until after those who feel that they are getting the worst of it have a chance to state their case. And I would hope that I would have the opportunity to interrogate these witnesses after the case has been made by those who feel that they have been getting the worst of it.

Now, I am also concerned that it has not been our privilege to have scheduled witnesses in the public interest. For example, the National Association of Regulatory Utility Commissioners represent, I should think, over 90 percent of the consumers out there in the United States, and they would like to be heard on this. They were informed that their request came in late.

I served for 14 years as chairman of the tax writing committee, and this would seem to me as if you planned to put a huge tax on a major corporation and you denied the chief executive officer the right to testify in his defense because he got his request in late.

And I just think that these people should be heard as well as the American Public Power Association, who was also informed that their request came in late. I doubt the chairman knew of that decision. But in any event, those people should be heard. And I will undertake to see that they are heard if I have to hear them under a shade tree myself.

But one way or another, these people who speak for vast numbers of American consumers out there have a right to state their case. And what they have to say ought to be considered. Now, I find it difficult to believe that this law has been administered the way that we would like to have it administered. And I make particular reference to my handiwork, the part that I played in putting that into the law, which is known as the Long-Cannon amendment or the Cannon-Long amendment. It was my idea—I couldn't get my way, but I came to terms with Senator Cannon, so we did

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have what we call the Long-Cannon or the Cannon-Long amendment, seeking to protect the public interest against exploitation.

And so far, it looks like the Long-Cannon amendment has done more harm than good; that so far the railroads are batting 1.000, to use a baseball terminology. Shippers are batting zero. Consumers are batting zero. Now, we are told by the Commission that there have been compromises reached—I think this is great news, that the consumers or shippers have received any benefit whatever, which I assume they did if they signed the compromise—but these are compromises. Now, when a lawyer makes a compromise, he has to think in terms of what his chances are.

You are looking at the batting average on a large number of cases, goodness only knows. How many filings have there been, Mr. Chairman?

Mr. TAYLOR. How many filings?

Senator LONG. Yes. How many filings on rate cases under this act for consumers and shippers?

Mr. TAYLOR. There were over 800 filed under section 229 and over 800 of those have been settled. And I do have some numbers. I don't know that this is the appropriate time to do it, insofar as rate complaints are concerned, because the allegation that we have never found a rate unreasonable, either in the coal area or any other area, is simply not true.

I would be glad to give those numbers to you now if you would like.

Senator LONG. I would like to have those, but first I would like to know those that went the whole route to final decision. How many of those were decided against the railroad?

Mr. TAYLOR. OK. Since Staggers, there have been 36 cases where a rate has been found unreasonable. Six of the cases were decided by the entire Commission. Two of the cases involved coal.

Since Staggers, there have been eight coal cases where a rate has been found unreasonble. Two of the cases were decided by the entire Commission. And as I said, we had well over 800—I think it was 864 section 229 rate complaint matters and of those, well over 800 have been settled and resolved.

When I first got to the Commission, I was told you are just simply never going to be able to handle all of this enormous number of complaints that have been filed. But we have been able to handle them and most of them have been worked out to the satisfaction of both the shipper and the carrier through voluntary settlement.

Senator FORD. Mr. Chairman, can you tell how many of those cases, as they relate to coal, were on your calendar prior to Staggers?

Mr. TAYLOR. I cannot give you that off the top of my head. Maybe one of my colleagues here can.

Senator FORD. Well, you know that most of them were. They were there over 5 years before you settled them.

Senator ROCKEFELLER. And they were under the old pre-Staggers reasonableness test.

Senator FORD. That is right.

Senator ROCKEFELLER. They were settled very recently and very conveniently in time perhaps for this.

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Mr. TAYLOR. No, Senator, they were not settled in time for this. The process has been going on for a long time.

Senator ROCKEFELLER. They were on the books 5 years, 4 or 5 years.

Senator FORD. You look at the trend, and you will find that most things that are controversial settle the day before the hearing.

Mr. TAYLOR. Well, that is true. I agree with that.

Senator FORD. That is in the record.

Senator LONG. I wish we had had the opportunity to hear the complainants state their position first. We will have to wait until they do say something. But I am told that those few cases that were decided for the shippers were cases filed under pre-Staggers principles, on the basis of the law before the Staggers Act.

Mr. TAYLOR. What would probably be helpful, Senator, and we will be glad to do that for the record, is to supply you with information on each and every one of these cases, when they were filed, when they were resolved. We can do that. I cannot give you that off the top of my head, but we will do it for the record if you would like.

Senator LONG. I would like, if I might, Mr. Chairman, to have the opportunity to hear those who have come here to complain. And we are not talking about some constant complainer. We are talking about, among others, the private power industry itself coming and complaining. They are a regulated industry, but when they come in complaining, they know something about regulation. They have lived under it as long as they have had their companies.

And so I would like to hear their case and then have the opportunity to address my questions to the Commission.

Senator PRESSLER. Let me say that I understand now why Senator Packwood said, Larry, how would you like to chair this hearing for awhile?

But in any event, let us proceed in regular order here. We have another Senator and a Congressman, and then we will proceed with 10 minutes of questioning and keep moving along.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. Senator Pressler, let me just say I appreciate your willingness to chair this. I just happened in. But as you note, just looking at the witness list, it says at the bottom, "not necessarily in order of appearance." You are the chairman and you can schedule it any way you want.

I learned the art of chairing a hearing, for whatever it is worth, under the leadership of Chairman Long of the Finance Committee. The way we used to do it was that the Congressmen would testify first, if there were any, and then the Government witnesses would testify, and then everybody else and his brother would testify, often in panels, later in the day.

But I don't think that that necessarily is the best approach, if there is another approach. Further, as far as the number of witnesses or any other days of hearings, I cannot speak for Chairman Packwood, but this committee has always been willing to hear any number of witnesses on any subject. For example, on Conrail, we have had days and days, as you know, of hearings on that subject.

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So I don't think there is any effort—Senator Long, if you believe that there are more witnesses that should be heard from, I am sure we can schedule other days of hearings on the Staggers Act.

I have always thought that it made sense when Government witnesses are here to let them testify, so that they can get on with whatever else they do. Most of these Government witnesses spend a tremendous number of days and hours testifying before congressional committees. I think that is the basic reason why they generally have been accorded the opportunity to speak first.

But I don't think that that is necessarily written in stone anywhere.

Senator Long. More often than not, may I say, Mr. Chairman, when we were holding hearings in the Finance Committee, we were holding hearings on recommendations being proposed by the administration. And the Secretary of the Treasury, for example, would be the lead witness because he was the lead advocate of the bill.

In this case, as I said, I could not understand why the hearing was organized in this fashion, because I thought that we were to have a hearing on something that six of us on the committee were sponsoring, along with seven other Senators. I found when I got here that this is an oversight hearing, and I realize now that the letter that the chairman sent to me said that this would be an oversight hearing rather than a hearing on the legislation that we proposed.

I would hope that in due course, the committee would consider our legislation. I would hope that the committee thinks enough of six of its members that it would accord them a hearing on their proposal and even a vote in due course on their proposal.

I am not complaining about this matter except that I would like the opportunity to interrogate the Commission after we hear the witnesses who have complaints about the situation as they find it.

Senator Pressler. Does this create a great problem for any of our Government witnesses?

Mr. Taylor. I was just going to say, Senator Pressler, we would be happy if you, whoever is running the show here, want us to come back a second time after we appear here today and respond to anything that——

Senator Pressler. I think that would be a better way. These hearings were set up with the participation of the various staffs. I think we are going to have to proceed in this order today. However, I am very much for another hearing where we could get Senator Rockefeller's people in, and Senator Long's people, and I have got some people I would like to have in. I can't speak for the chairman of the subcommittee but I will join in an effort to get another hearing. But I think we are going to have to proceed now as planned. As I understand it, this is the order and I can't just change the order. Senator Packwood may come back and be very upset.

Senator Long. That is all right with me, Mr. Chairman, with the understanding that we would like—at least I for one want to, and I think others might want to interrogate the members of the Commission and other members who head this list after we have heard from those who are complaining about matters.

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Senator **Pressler**. Absolutely. Either in another hearing, or if they can stay. But let's proceed. We have Congressman Tauzin.

Mr. **Taylor**. And we will be glad to come back.

Senator **Pressler**. We will yield to you. Can you do it in 5 minutes?

Mr. **Tauzin**. I will very much try, Senator.

Senator **Pressler**. Can you summarize it? We are very glad to have you here.

STATEMENT OF HON. BILL TAUZIN, U.S. REPRESENTATIVE FROM LOUISIANA

Mr. **Tauzin**. Thank you.

Mr. Chairman and members, let me first of all say that the distinguished Senator from West Virginia has put this thing quite adequately in perspective. It is not a question of whether we want to reregulate the railroads. I represent several on the Committee of Service Transportation and Fossil Fuels on the Energy Commerce side, and along with Hal Rogers and Nick Rahall, we are principal cosponsors of the Consumer Rail Equity Act.

It is an act like the Senate act, but it is designed simply to do what Congress intended in Staggers: To ensure that the ICC regulates the captive shipper, the monopoly case, not the competitive case. That is all we are asking.

And the Senator from West Virginia indeed put it in perspective. Is it congressional intent that the ICC should regulate a captive shipper under rules that provide that every railroad in the country is revenue-inadequate, even Norfolk Southern, when 90 percent of its revenues are derived from its two railroads, and there is enough money on the top of the table to buy up Conrail—even Norfolk Southern, who the Secretary of Transportation has called a "highly profitable railroad" in the face of the ICC's determination that it is a revenue-inadequate railroad.

Mr. Chairman, you heard also from Senator Ford about the stand-alone cost test used by the ICC in these monopoly cases. Stand-alone test. Now, the Edison Electric Institute applied that stand-alone test, a unique test when it comes to railroad regulation or any utility regulation in the country, applied it to Pepco, just to see what would happen. And guess what? If that test were applied to Pepco, the rates to consumers——

Senator **Long**. You are talking about the Potomac Electric Power Co.

Mr. **Tauzin**. Potomac Electric Power here in this area, Potomac Electric. If those tests were applied to Pepco, utility rates to consumers on the Pepco system would have to increase over 100 percent tomorrow. That is how ridiculous those revenue adequacy tests and stand-alone tests are.

Imagine, if you will, the public utility company deciding on what your utility bill would be at your house or business based upon the stand-alone test of a utility serving you alone, building a line just to get to your house or your business.

Senator **Long**. What it would cost you to build your own electric generating plant?

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Mr. TAUZIN. That is about the size of it. That is how ridiculous a standard it is.

Mr. Chairman, we asked at our last hearing on October 3 for some figures of whether any rate cases have been handled in favor of any shipper. Let me give you the facts on it.

We asked Mr. Ronald Young to tell us a little bit about the rate cases and about the manner in which the rate cases are being handled.

Senator PRESSLER. Let me just interrupt for a minute. There is a vote on the Senate floor. I am going to try to keep this hearing going so we keep the ship floating. There is going to be a 10-minute rule on questions. I will go vote now and run back, so let's try to keep the hearing going. Is that all right?

Senator LONG. Yes; that is fine.

Senator PRESSLER. OK. Go ahead.

Mr. TAUZIN. We heard Mr. Young testify that the guidelines, the new guidelines would be too burdensome for any small shipper to try to use in putting on a rate reasonableness test. We also heard him say they did not recall any small shipper having come before the ICC with a case. I think he may have overlooked the case of *McCarty Farms.* That is a case of a group of Montana farmers, grain farmers and cooperatives, pooled their resources to bring such a case. They had to get a bunch of them together to bring the case. But they brought one.

Today, several hundred thousand dollars later, 5 years later, and after having the State of Montana appropriate public funds to keep the case going, these poor grain farmers are starting all over again. I think Mr. Young overlooked some small shippers here.

We also found some testimony, by the way, from a small shipper in West Virginia. She testified that the railroad to which she was captive had told her she would have to make a $1.5 million investment in improvements for the rail loading facility, but even after she did so she could not get any rate reduction, and that the railroad would not even offer her any assurances that once she made that substantial improvement that they would not proceed to abandon her line.

Mr. Chairman, that does not sound to me like the kind of actions of a railroad that is being disciplined by competition or by the actions of an Interstate Commerce Commission properly regulating in a captive or monopoly shipper case.

Now, we also heard from Mr. Dempsey, Mr. William Dempsey, the president of the American Railroad Association. We asked him to give us any cases where a shipper won. Well, he did cite two coal cases. But guess what? Both coal cases, Senator—you are right—were filed prior to Staggers, were heard on old pre-Staggers rate reasonableness test and which, by the way, the others strongly criticized.

In fact, in a letter on November 27, 1984, ICC staff said those two cases—and many others like them—were decided under—and I quote—"outdated market dominance and rate reasonableness standards." That is the case that they cite as a victory, cited under outdated market dominance and rate reasonableness standard.

Well, the two cases are *Coal, Wyoming to Redfield, Arkansas,* and *Volume Rate of Coal, Acco, Utah to Moapa, Nevada.* In the

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third case they cited, this is an iron ore case, this was not even a rate reasonableness test. This was a case in which the ICC was asked up uphold a contract between the shipper and the railroad, and even when the court upheld the contract, it found one of the rates was too low and it raised it. That is a case where the shipper won?

Those are the three cases cited to us. Now, if you look at the *Redfield* case, which is one of the two coal cases cited, there was a little relief given to the shipper in a pre-Staggers environment. The relief was 12 cents, OK. If you interpolate 17 months of relief before the ICC has taken up the case again under its new standard, if you interpolate 17 months of rate relief, you come to $290,000 of relief on $45 million of rail freight charges.

Now, I ask you—we have asked for instances where captive shippers received any rate reduction, and all they could point to was $290,000 of relief over the course of 5 years, hundreds of cases, and literally billions of dollars of freight charges. That is the record of the ICC in this case.

Mr. Chairman, I was in Broussard, LA, in our great State just recently. I heard a story about a fellow who got stopped for a traffic ticket in Broussard. The patrolman was writing out the ticket, and a fly started bothering him, and he was waving it away and writing out the ticket, swiping at the fly. And finally the guy in the car said, you know, Mr. Trooper, he said, those circle flies are pretty bad, aren't they? The trooper said, what do you mean, circle flies? He said, oh, you know, those circle flies, the ones that circle the rear end of a horse. And the trooper put his book down and looked rather sternly at him and said, sir, are you trying to tell me something? And the fellow said, no, sir, not me; but, you know, you can't fool those flies.

Mr. Chairman, you can listen to the ICC tell you they are properly regulating these monopoly cases. You can listen to others tell you that, you know, we are trying to reregulate the railroads and all sorts of horrible cases. But the facts are there, Mr. Chairman. Every railroad rated revenue-inadequate, every one rated on a test that you and I would be ashamed to apply to any utility customer in America. The flies don't lie. There is something that stinks at the ICC, Mr. Chairman: It is the credibility of a board that is supposed to be protecting the American consumer against unreasonable rates and has never once done so. I submit not one case, not one case. Your batting average figures are correct, Senator. Not one case did they favor the consumer; all of them in favor of railroads that are so revenue-adequate they can go around buying other railroads up, other shipping companies up, trucks, barges, everything around they can find.

That is the history of the ICC and the flies don't lie.

[The statement follows:]

STATEMENT OF HON. W.J. TAUZIN, U.S. REPRESENTATIVE FROM LOUISIANA

Mr. Chairman, thank you very much for scheduling these oversight hearings on the operation of the Staggers Act and for granting me an opportunity to testify before you today. As you know, I represent the Third District of Louisiana, which is located in the extreme southern part of our state, and I serve on the Surface Transportation Subcommittee and the Fossil and Synthetic Fuels Subcommittee of the House Energy and Commerce Committee. I am also, along with my colleagues Hal

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Rogers of Kentucky and Nick Joe Rahall of West Virginia, a principal co-sponsor of the Consumer Rail Equity Act, H.R. 1190.

Mr. Chairman, I am a strong advocate of deregulation wherever competition exists. The marketplace will always be the best regulator of prices. The Staggers Rail Act of 1980 invited this principle. As you are well aware, the Staggers Act deregulated competitive rail traffic, provided contracting authority to the railroads, which was long overdue, and completely deregulated the rates included in such contracts. At the same time, the Act provided continuing protection for captive shippers who were without market power to protect themselves against unreasonable high rail rates. Finally, the Act further provided the Commission with discretionary authority to assure maximum competition between the railroads.

For the last several years, I have received numerous complaints from my constituents concerning railroad prices and practices and the absence of protection by the Interstate Commerce Commission. These complaints have come from our Louisiana utilities which have shifted from natural gas to coal for electric generation as encouraged by Federal policy. These complaints have come from sugarmill operators who are captive to single railroads. The complaints have come from major chemical and other manufacturing facilities that are located along the Mississippi River and are captive to public transportation haulage for either their raw products or their finished products. The complaints have come from the Commissioners of our ports who have complained about railroad prices and their impact on our port facilities.

Mr. Chairman, my concerns about the activities at the Interstate Commerce Commission have increased throughout the long Conrail debate that has swirled around our country and due to the testimony that was presented to the House Fossil and Synthetic Fuels Subcommittee on September 18 and October 3, 1985. These events have convinced me that the Commission is on the wrong path of implementation of the Staggers Act and the Commission is either unable or unwilling to correct its course of action.

Mr. Chairman, the Conrail debate has focused my attention and the attention of my colleagues on the issue of railroad financial need, the problem of captive shippers, the concerns regarding switching arrangements and joint rate agreements and the problem of railroad abandonment. In testimony before our Subcommittees and in private visits and briefings by several of our nation's railroads, it has become very clear to me that some of our major railroads are undoubtedly financially healthy. Nevertheless, the Interstate Commerce Commission continues to determine that each of our major railroads is financially unhealthy.

This would have little interest to any of us if the Commission did not continually state that it allows financially unhealthy railroads to charge higher rates to captive shippers in an effect to help the railroads achieve revenue adequacy. I must say, Mr. Chairman, that I do not believe that the two Norfolk Southern railroads are revenue inadequate, certainly not to the extent the ICC says they are. The two railroads provide approximately 90 percent of the pretax income to the holding company that is attempting to purchase Conrail. The Secretary of Transportation has recommended that we sell Conrail to Norfolk Southern, stating that Norfolk Southern is a "very profitable" company. The Interstate Commerce Commission, nevertheless, continues to determine that both of Norfolk Southern's railroad operating companies are grossly revenue inadequate. Given a choice, Mr. Chairman, between these two inconsistent findings by government officials, I believe that the Secretary of Transportation's view of Norfolk Southern's financial health is more accurate.

The revenue adequacy problem was brought into sharp focus by the testimony of Mr. Ronald Young, Director of the Bureau of Accounts at the Interstate Commerce Commission before the Fossil and Synthetic Fuels Subcommittee on October 3 of this year. Mr. Young's attention was invited to an ICC staff study of the financial viability fo the Pittsburgh and Lake Erie and Guilford Group railroads, in connection with the proposed sale of Conrail. That study used a number of measurements of financial health, rather than the mechanical formula for revenue adequacy used in the ICC's annual determinations. Mr. Young justified the ICC's simplistic revenue adequacy formula in part, on the ground that it was the best way to accomplish the Commission's task, and I quote, "with the least amount of resources." If an individual shipper was unhappy about the Commission's revenue adequacy finding, Mr. Young said, the shipper could challenge it in an individual rate case. So in effect, Mr. Young's argument was that it takes too much Commission resources to do a thorough job, but the beleaguered captive shipper—whose funds are already drained by high railroad rates—can somehow find the resources to do that job in a rate case. I submit to you, Mr. Chairman, that that is not what the Congress intended.

The Fossil and Synthetic Fuels Subcommittee hearings also focused on another key captive shipper issue, the question of how the ICC determines whether a rate is

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reasonable. To be more precise, I should frame the question as one of how it has come to pass that the ICC has yet to determine a single captive shipper rate to be unreasonable under the principles it has adopted to implement the Staggers Act.

Five years after the Staggers Act, we now have a new rate reasonableness test, the Coal Rate Guidelines. All indications are that these Guidelines will be applied to other captive commodities as well. For most captive shippers, these Guidelines can only come as a severe disappointment. You will no doubt hear much about the Guidelines during these hearings, but let me tell you what the House Fossil and Synthetic Fuels Subcommittee heard about these Guidelines.

We heard Mr. Young concede that the Guidelines would be too burdensome for the small shipper to try to use in putting on a rate reasonableness case. We also heard him say that he didn't recall any small shipper cases at the ICC. I think he may have overlooked the *McCarty Farms* case, in which a group of Montana grain farmers and cooperatives pooled their resources and brought a rate case at the ICC. Today, several hundred thousand dollars and five years later, and after having the State of Montana appropriate public funds to keep the case alive, those poor grain farmers are starting all over again. I think Mr. Young overlooked those small shippers.

I am sure the members of this Committee have heard from constituents who won't pursue a case before the ICC because it is too expensive, and won't result in a favorable ruling anyway. We heard testimony from a small shipper, Mr. Chairman, a small coal producer from West Virginia. She testified that the railroad to which she was captive had told her that she would have to make $1.5 million in improvements to the rail loading facilities, that even after she did so, she wouldn't get any rate reduction, and that the railroad wouldn't even offer her any assurances that once she made this substantial investment, they wouldn't proceed to abandon the line. Mr. Chairman, that doesn't sound to me like the actions of a railroad that is being disciplined by competition, by the threat of an order from the Interstate Commerce Commission—or by anything else, for that matter.

Something else of interest concerning rate reasonableness came up at those hearings. Whenever I am told that the Staggers Act is working, I always ask whether anyone knows of any captive shipper rate that has been reduced by the Commission under Staggers Act principles. So far, no one has been able to identify one for me. Mr. William Dempsey, the President of the Association of American Railroads assured us at the hearing that there were such cases, and he agreed to provide them to the Subcommittee. In a letter dated October 16, 1985, he gave the Subcommittee a list of three such cases. Let me tell you about those three cases.

Two of them were coal cases filed before the Staggers Act, and decided shortly after the passage of the Staggers Act, under the old pre-Staggers rate reasonableness test that the AAR and others so strongly criticized. In a letter to my colleague Nick Joe Rahall dated November 27, 1984, the ICC staff said those two cases (among others) were decided under, and I quote, "outdated market dominance and rate reasonableness standards." Both of these cases were recalled from Court on the motion of the Commission and held in limbo pending the outcome of the *Coal Rate Guidelines*. Both of these "victories" cited by Mr. Dempsey are included in an order dated October 3, 1985, in which the Commission announced it would reopen all pending coal cases and decide them under Coal Rate Guidelines. Those two cases are *Coal, Wyoming to Redfield, Arkansas*, Docket 37276 and *Volume Rate on Coal Acco, Utah to Moapa, Nevada*, Docket 37409. Thus, those shippers have won only the right to start all over again.

The third case cited by Mr. Dempsey as a shipper victory, *Rates on Iron Ore to Escanaba, Michigan*, Docket 38566, was not even a rate reasonableness case. The Cleveland Cliffs Iron Company had entered into a contract with a railroad for three rates. Even though the agreement contained an escalator clause, the railroad was unhappy with the contract, and so filed new tariff rates. The shipper simply asked the Commission to order the railroad to live up to the terms of its own arms-length, negotiated contract. That's not a rate reasonableness case, nor can it hardly be considered a "victory" when a shipper succeeds in having a railroad abide by its own contract. In fact, though, while the Commission found the agreement to be valid, it refused to enforce the contract as to one of the three rates, saying that rate was too low. It seems to me that the railroad, not the shipper, won that case.

Now I am told that in the *Redfield* case, the Commission—operating under pre-Staggers Act principles, remember—in fact ordered the rate reduced from $18.75 a ton to $18.63 a ton, or 12 cents, and that the reduction remained in effect for 17 months until the jurisdictional threshold went up. According to the Commission's order, about 770,000 tons were shipped in the 6 months prior to the beginning of the Commission proceeding. So extrapolating that reduction over the full 17 months

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means the shipper realized a total savings of about $290,000 on $45 million of rail freight charges.

Now, Mr. Chairman, I had asked for instances in which captive shippers had received rate reductions, and all that anybody could point to is possibly $290,000, over the course of 5 years, hundreds of cases, and literally billions of dollars of freight charges. Lest any captive shipper nonetheless find a ray of hope in this, I would remind him that that savings in that case was based on pre-Staggers Act principles and that the shipper in that case, which began before the passage of the Act, must now start all over again 5 years later. I submit to you, Mr. Chairman, that that is not what Congress intended.

Mr. Chairman, I share these examples from what we in the House have been hearing recently because I believe that the time has come for Congress to recognize that the system we put in place in 1980 to protect those who could not enjoy the benefits of deregulation is simply broken down. The Commission will not change its revenue adequacy test. The Commission has produced an expensive and unworkable rate reasonableness test. The captive shipper continues to bear the entire burden of proof at the Commission. The result is a system which decrees that no railroad is or is likely to be revenue adequate, a system which offers no captive shipper any reasonable hope of relief from high railroad rates, and a system which through mergers and cancellations of competitive access arrangements, promises to create even more captive shippers.

Mr. Chairman, these oversight hearings should help demonstate that little has happened since the last oversight hearings held before this Subcommittee, and that the same complaints are still being heard. I urge this Subcommittee to proceed to hold hearings on S. 477, the Senate bill that embodies the Consumer Rail Equity Act, and proceed to mark-up on the bill. It is a modest bill, it does not reregulate any transaction or contract deregulated by the Staggers Act, and is simply designed to implement the captive shipper and procompetition protections of that Act in a meaningful way.

Thank you, Mr. Chairman and members of the Subcommittee.

The CHAIRMAN [presiding]. Congressman, thank you very much for your testimony. I don't know if anyone has any questions for you. I think it is unfair to you probably to keep you around, waiting to find out, and people may or may not return.

If you would like to stay, fine. If not, thank you very much.

Let me ask what the status is. Chairman Taylor, you have given testimony; is that correct?

Mr. TAYLOR. We have made our summary statement, Senator Danforth. And Commissioner Strenio has given his, and we have had a little dialog back and forth but we have not answered any questions as yet.

The CHAIRMAN. All right. Well, we will recess until people start coming back after the vote. And if you could stay here for questions, I would appreciate it.

Mr. TAYLOR. We certainly will. Thank you.

[Recess.]

Senator PRESSLER [presiding]. The hearing will resume. Can we close the door there, please? Would the policeman close the door? Let's bring the hearing back to order.

We will resume here. I have a number of questions for Chairman Taylor which I will ask at this point.

Mr. Chairman, do you think that ICC regulations encourage the preservation of light density line service and, if so, in what ways?

Mr. TAYLOR. Well, I think there are some tools, Senator, to create solutions to protect small shippers and light density lines from abandonment problems. You mentioned the fact that you have had two abandonment situations in South Dakota, both of which fortunately have been favorably resolved. One was the result of a vote of the Commission and the other was the result of the

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good efforts of our Office of Special Counsel going out and working with your people and, eventually, the Chicago & North Western abandonment was withdrawn.

I think that is the first tool. It does not necessarily have to mean that simply because a line is put up for abandonment that, in fact, it is going to be abandoned. You have had two good experiences on that score.

Also, an offer of financial assistance to continue rail service can be made to acquire or subsidize the line. We have what is called the Feeder Line Development Program which is available to shippers, although I must admit that it has not really been used since the Commission streamlined the procedures a couple of years ago.

We also have seen railroads that are willing to operate lines that they have abandoned under contract because their common carrier obligation has come to an end. But, I think the best tool is the short line railroads. I just went out to Illinois and spoke to all of them and they are a growing number. Short lines can and do provide a shipper with more personal and lower cost service. And very often they can come in and provide service where a big class I operation cannot. They have greater flexibility with their labor force and I know that a number of Conrail's expedited abandonments under NERSA involved lines that have been taken over by short lines.

We are also at the present time considering rules that will make it easier and faster for short lines to start offering service, and I think that is probably, if I had to pick one of these things I have discussed, the best solution. I guess you know that we have put out a couple of pamphlets in this area, and we have a small business assistance office which has been very active in telling people how to become a short line railroad. We have endeavored to be as helpful and provide as much assistance as we can.

Senator PRESSLER. Of course now, on the abandonments, that has only been 2 out of, I think, 120. I would just add that note.

Mr. TAYLOR. Mr. Gitomer has some numbers on abandonments. By the way, let me introduce these gentlemen at the table with me again for the record, since we do not have signs. I might say, Senator Long, you are correct; over on the House side, they take a piece of cardboard and they write on it by hand, but at least the names are out there.

On my left is Lou Gitomer, and his title at the Commission is the Director of the Rail Section of the Office of Proceedings. And on his left is Ron Young, who is the Director of the Bureau of Accounts, and I might say that he is particularly knowledgeable about the Ex parte No. 347 *Maximum Coal Rate Guidelines* proceeding, which I am sure we are going to be getting into eventually. And on my far right is Bill Southard, and he heads up our Office of Transportation Analysis. He is an economist.

So, hopefully, you will know now who we are.

Senator PRESSLER. Great.

Well, in your opinion, can these lighter density lines that I have mentioned make it in the long run, or are we simply tilting at windmills?

Mr. TAYLOR. No, I don't think we are tilting at windmills. I think that they can. They are not all going to make it; it depends upon

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what kind of a shipper situation is confronting them. Obviously, the day is past when you can have a railroad provide service to everybody in every nook and cranny of the United States on an unprofitable basis. But I think that if anybody can make it, these short lines can, and they have been adding to their numbers substantially. I think that where there is an opportunity they will make the most of it.

Would you like some abandonment figures?

Senator PRESSLER. Yes.

Mr. TAYLOR. Let me give the mike to Mr. Gitomer. He has them.

Mr. GITOMER. For fiscal year 1985, the Commission received 109 abandonment applications. It granted 80 of those; it denied 3 applications; it dismissed 20 applications. I think of more importance, of those applications that were granted, there were nine offers of financial assistance made to continue service to the shippers.

The Commission still has two additional offers pending before us.

Senator PRESSLER. So there are 3 out of about 200 that have not been granted; is that right?

Mr. GITOMER. Three out of 109 applications filed.

Senator PRESSLER. OK. Now, since Staggers—and you mentioned you spoke to the short line operators and so forth—do you think the establishment of short line or regional operations in rural, less densely populated States such as South Dakota, is a viable alternative to the abandonment problems? And, if so, what are the advantages?

Mr. TAYLOR. Well, I think it can be viable. I think a lot of that remains to be seen, but I know the short lines are very active and they are doing a lot of things. The ICG system has been substantially trimmed down in the Midwest and a lot of that has involved short lines coming in and picking up the service responsibility.

I cannot promise you that every line that has been abandoned is going to be picked up by a short line and profitably operated for an indefinite period of time, but there is a pretty good track record so far.

Senator PRESSLER. In these lesser populated areas or at least in South Dakota, we have stressed the need for give and take on the part of shippers, carriers, labor and local communities in order to make otherwise unprofitable lines viable.

What steps can each of these groups take toward helping preserve these lines and what can we do to encourage that process?

Mr. TAYLOR. Well, I don't know that I can give you a laundry list of suggestions. Our small business assistance office stands ready to work with all kinds of local people and local individuals and suggest alternatives to them.

Dan King heads that effort up. I am very proud of the fact that both his office and our office of special counsel have been responsive to the needs of rural America, both insofar as the abandonment of rail service and also the discontinuance of bus service, which I know is another matter of great concern to you.

Senator PRESSLER. Well, yes. I guess we have stressed the fact that we cannot rely on long-term excessive Government subsidies or support programs to keep these light density lines operating. And we must find interim steps that we can take to provide start-

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up assistance for small operators and find ways to efficiently utilize our resources in that area.

Mr. **Taylor**. Some States are getting into the act themselves. South Dakota has been very active in seeing that they continue to have some rail service.

Senator **Pressler**. That is correct. And there have been initiatives there, although we are struggling with other lines.

Many communities in States like South Dakota complain that the railroads often let the lighter density lines wither on the vine by not investing any capital in maintaining the physical plant.

Would it be feasible to require the operators to either maintain these lines or divest them before they become nothing more than rusty ribbons of rail? If so, how should we determine at what point that divestiture should occur?

Mr. **Taylor**. One of the things that has been happening with Staggers is that a lot of the deferred maintenance that used to go on—and you are certainly correct that it did—I heard this morning all the comments about how wealthy the railroad industry has become, but I think you just have to go back to the late 1970's to remember that all of us were terribly concerned that it was on the brink of bankruptcy. We were concerned about bankruptcies all over the country.

As the railroad industry has recovered—and it is not out of the well by any means yet—but one of the big things that has happened is that deferred maintenance has not occurred to the extent that it did before, and I think that is very important. That has allowed for increased efficiencies, and I think in the long run it has benefited shippers.

We do what we can to see that lines don't get out of order and don't lie in disrepair. But we know that some of them are, and to the extent that vital service is needed over those lines, I know the Short Line Association looks around for all the opportunities they can, and they are there to pick up on it if there is a line about to be abandoned that anybody can make any money out of.

Mr. **Gitomer**. If I might add, there is a program available—the Chairman mentioned it—the Feeder Line Development Program—where a group of shippers or a short line railroad can come in and force a class I railroad to sell its line to that group.

Senator **Pressler**. At what point is that? I mean how do you determine that?

Mr. **Gitomer**. Under the statute, it is at whatever point the shippers feel they should take over the line. The line need not be abandoned. It can be at any point in time, although it is easier when the railroad first announces its intent to abandon the line by putting its line on its system diagram map, a form of notice prior to abandonment.

Senator **Pressler**. But the point I was making, is there anything that requires or encourages the railroads to keep the lines in good repair? It seems as if they almost have an incentive to sort of let it wither on the vine

Mr. **Gitomer**. The incentives for the railroads to keep their lines in good repair is continual traffic that requires their service.

Senator **Pressler**. Well, that is true, but if they really want to get rid of a line they can take a number of steps, just letting it go

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to pieces, so to speak. That was my question. I don't think you are quite addressing the nub of my question.

Mr. TAYLOR. You are probably talking about intentional downgrading. In an abandonment proceeding that is something we look to see if that has obviously occurred—I can tell you, before I went on the Commission, a story that occurred out in Nevada, about a 15-mile line, and we thought it was very clear there that the railroad had engaged in intentional downgrading, and we made that allegation. That happened to be another abandonment case which was denied.

But we do look for that.

Senator PRESSLER. I understand that, but how do you determine that?

Mr. TAYLOR. Well, it is not an easy thing to determine. In this particular case, it took an enormous amount of work to show that service had just been cut back and cut back to the point where it was only being offered on every other Sunday, but if it is there and it can be identified—and we look for it—it is taken into account in an abandonment proceeding.

Senator PRESSLER. Can you discuss how the ICC's revenue adequacy test was arrived at, and what is the current benchmark of revenue adequacy, and what will it take for the class I carriers to reach that mark?

Mr. TAYLOR. That was actually done, Senator, before I came to the Commission, and it was upheld in court in March 1981. I went on the Commission in June 1981. I guess you know that the measuring stick is that a railroad is allowed to earn a rate of return on the plant that is used for transportation service which is equal to the cost of capital. That is the standard that we use to determine revenue adequacy.

And we have a proceeding going on now, which does not really change the basic concept, but which certainly fine tunes it. I would be glad to have director Young address that. We hope to have it out, at the very latest, next spring. We have had several drafts done and redone on it—to hopefully fine tune the applicability of the concept and how it is done.

Let me just say one other thing about revenue adequacy, because to me the unfortunate thing about revenue adequacy are the very words. It is a matter of semantics. If you turn revenue adequacy around the other way and say that a railroad operation is revenue inadequate, it automatically conjures up in your mind that this railroad is on the brink of disaster, it is about to go bankrupt. That is not the case.

What we mean by revenue adequacy, and I would be glad to have Director Young expand on this, too, is long-term financial viability. It has nothing to do with cash in the jeans or what has come about as a result of some favorable tax treatment, that a railroad suddenly has more cash to deal with. What we are talking about is long-term financial viability. That is really what revenue adequacy means.

But the unfortunate thing about it is, if you turn it around and you talk about revenue inadequacy, then you get back to this question that some of you have already raised: How can the Norfolk Southern be revenue inadequate? Well, it is approaching revenue

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adequacy. It is getting very close to it. But the unfortunate thing is the terminology. If we are talking about long-term financial viability, they really are earning a rate of return that is going to allow them to continue on in business and be a financial success for the long term, that is what it means. And revenue inadequacy does not mean that somebody is about to go broke.

Senator **Pressler**. Thank you. My time is up.

Senator Long.

Senator **Long**. No questions.

Senator **Pressler**. Senator Danforth.

The **Chairman**. Mr. Chairman, the Staggers Act was passed when? 1980, was it?

Mr. **Taylor**. 1980. October 1980. We are talking about 5 years.

The **Chairman**. And prior to that time, the state of the railroad industry in the United States was very precarious, wasn't it?

Mr. **Taylor**. Oh, it was really a disaster. It was under the heavy-handed pervasive regulation of the Interstate Commerce Commission. It had lived in this atmosphere under this protectionist governmental umbrella since 1887, well over 90 years.

Railroads were going bankrupt. We were concerned, as a matter of fact, in the late 1970's with the possibility that we might have to nationalize the railroad industry. That is how bad it was.

The **Chairman**. Well, we did in the Northeast, didn't we?

Mr. **Taylor**. Yes. Most certainly. That is what Conrail is all about.

The **Chairman**. And we took over Amtrak to get the passenger rail service out of the hair of the freight rail system, didn't we?

Mr. **Taylor**. That is correct.

Mr. **Strenio**. Senator, just to give some flesh to the bones of where the railroad industry was in the 1970's, they were posting annual returns at that time in the range of 2 percent. Investors were putting their money elsewhere. There were widespread freight car shortages. Main line track speed was often restricted due to its poor condition. Fixed plant deteriorated, cars derailed while standing still, and 10 carriers representing approximately 22 percent of the Nation's total rail mileage filed for bankruptcy between 1970 and 1979.

So to say there was a problem then is an understatement.

The **Chairman**. And was rail service being lost, for example, in the Midwest?

Mr. **Strenio**. Rail service was being lost, in the Midwest and elsewhere and shippers were suffering tremendous problems because of the uncertainty of whether they would be able to get a car or whether their shipments would arrive on time. It was not a happy time for shippers. In fact, the problems they were having in large part gave rise to the relief efforts embodied in the Staggers Act.

The **Chairman**. Was it a real threat to certain areas in the Midwest?

Mr. **Strenio**. I think it was, as you mentioned, a serious threat to areas not just in the Midwest, but in the Northeast as well. If you look at the deferred maintenance situation which gave rise to the problems with speed and reliability of service, the ICC estimated in

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1978 that just for the large carriers, deferred maintenance at that time amounted to $[illegible].5 billion.

Capital expenditures in 1978 were only $855 million, which was inadequate. By 1984, that picture has been turned around entirely. In 1984, the expenditures for capital improvements were $2.938 billion, which is an increase of more than three times, and that has rebounded to the advantage of shippers, which is and has to be the prime concern.

The CHAIRMAN. Do you attribute the improved health of the railroad industry to the Staggers Act?

Mr. TAYLOR. I don't think there is any question about it, Senator, and there is one other statistic I would like to add. Prior to Staggers, there was a $16 to $20 billion projected capital shortfall for the railroad industry. And what has happened in the short space of 5 years, this situation has been turned around. And we have even seen, under Staggers, Conrail become profitable. And nobody thought that was even a remote possibility.

Back in 1980 when this whole thing was going on, they were talking about cannibalizing the system and piecemealing it out, and even Conrail has been able to become profitable. But they are not out of the well yet, and that is the important thing.

The CHAIRMAN. Last year, some of us on this committee introduced a resolution relating to the ICC's interpretation of the Staggers Act. The resolution stemmed from hearings we held the year before. Some of us were quite critical of the ICC, feeling that it was misinterpreting the Staggers Act. Has the ICC been responsive to the concerns addressed by the resolution?

Mr. TAYLOR. Senator Danforth, I am very proud to say yes it has. That resolution was joined in by yourself and Senator Ford, Senator Kassebaum, Senator Jepsen at the time, Senator Exon and Senator Kasten. And I am pleased to be able to tell you that each of the six matters that were raised in Senate Joint Resolution No. 331 have been addressed.

And if I may, please, I would just quickly like to go through them. In our recent market dominance decision, Ex parte No. 320, we decided to consider evidence of geographic and product competition. This was one of the things you raised in that resolution. We have decided now that this should be considered only when the railroad proves that such evidence exists and that such competition is a real restraint on the railroad's rates.

You asked us to look at coal rate guidelines. We have clarified then and we have eliminated the 15-percent phase-in provision which became so controversial. That was never intended to be a floor, that railroads were guaranteed a 15-percent increase a year. It was intended to be a ceiling. But it was pulled out of the matrix and held up for everybody to see. See, the ICC is going to let everybody raise their rates 15 percent a year.

The 15-percent provision is no longer there. Shippers are allowed to come in now under the Ex parte No. 347 guidelines and prove a case for phase-in, and we think that is a very pro-shipper provision.

The Commission has adopted rules governing competitive access. That is the Ex parte No. 445 case which deals with joint rates, through routes, and reciprocal switching. That is available for the

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record. It has been voted upon. The decision is here for all of you to see and read.

The fourth thing in the resolution was our joint route and rate study, and that is now in the final editing stage in our Office of Transportation Analysis with Bill Southard. We will have that out in December.

Fifth, you asked us about interim rules to facilitate the discovery of contract information, a matter that I know Senator Kassebaum is particularly interested in. And I might bring you up to speed on that. We have some interim rules which we think have worked fairly well. We had a proceeding set to actually adopt final rules at a conference in October. At the last minute, we were asked if we wouldn't please postpone that conference because the National Feed & Grain Association was involved in negotiations with the American Association of Railroads, and they were going to come up with their own set of agreed-upon rules, which I always think is the way to do this. Rather than a bureaucratically imposed laundry list of rules, let it be worked out in the private sector to the extent that it can be.

And apparently that is going to happen. We have been advised that they have arrived at an agreement as to how discovery should be handled, and that we will have that agreement handed to us for whatever action we take with respect to it. We may have to renotice the proceeding, but in any event, an agreement has been arrived at on that, which I think is the last remaining important matter insofar as agricultural contracts are concerned.

And the last point, which we began to talk about a minute ago, is this matter of our revenue adequacy standards. And as I say, we have a proceeding now which is addressing the refinements of that. We have had several drafts prepared of the decision. That is the reason that it has taken as long as it has.

Director Young is in a position to talk about that in detail if you would care to. But the fact of the matter is that every single one of those items that you asked the Commission to address in your resolution in fact either has been addressed or is being addressed, and I am very proud to say that we have achieved that record, because I think the thought at the time was, please let's have the Commission do this. Let's not get involved in any legislation that we don't have to.

The CHAIRMAN. Right.

Mr. TAYLOR. I know I have discussed that with you and with Senator Kassebaum both. And, hopefully, we have done that.

The CHAIRMAN. Now, have you seen any moderation in the response of shippers? Are all shippers just in a total uproar about the Staggers Act and the ICC, or are there some signs of life?

Mr. TAYLOR. They most certainly not all in an uproar. To start off with, there is a whole group—and as I understand it, not solicited by the railroads—which has been in to meet with me. It is called CARS. And their plea is, please, Congress, don't play around with the Staggers Act. There are things that can be adjusted and done, but let the Commission do it. Don't go in there with a meat ax and chop up the Staggers Act—a piece of legislation that really has made the railroad industry healthy—because we need the railroad industry to conduct our businesses.

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You have a group in the middle that is sort of "watch and wait." It is called the procompetitive group. You are going to be hearing from them as well. And then you have a number of coal and utility people who really are not going to be satisfied unless the railroad industry is saddled with the same kind of utility regulation that they face from the States.

Now, the point is that unfortunately the railroad industry is competitive as to an awful lot of the services that it provides. It depends upon the measuring stick you use, but somewhere between 5 percent on the low side and perhaps 20 percent on the high side is business that is derived from the so-called captive shipper.

But the rest of that railroad's business is highly competitive. And, unlike an electric utility which operates as a monopoly within a prescribed service area, and has absolutely no competition at all, what the CURE legislation endeavors to do is to saddle the railroad industry because of the captive shipper business that is involved, somewhere between 5 and 20 percent, with what amounts to public utility type regulation.

And I simply say that is just the worst kind of a step backward.

Mr. Strenio. Senator, may I just briefly add one thing? I have made a point of trying to go out and talk with members of the groups that have been particularly upset; notably, the people in the coal industry. And I have stated to them that our goal in the Commission is following the lines of your resolution. We are, trying to make any legislative change in the Staggers Act redundant or not necessary, because the Commission can and should take care of the concerns that have been expressed.

And in private, a number of individuals from coal groups—coal groups that are still far from satified with where the Commission is—tell me that they have been pleased with the direction that the Commission has taken recently and that they share the hope that the Commission will continue on this track and be able to deal with these questions on its own without need for legislation, even though they are not, as indicated earlier, absolutely pleased with where we are or absolutely certain that that will occur.

Mr. Taylor. Senator, could I just add that I just had the NIT League in, and the whole crew sat in my office and said we want to give these things a chance to work. And I think it is important to point out, too, that some of the resolutions that have been arrived at, while they have been Commission-crafted, they really are the result of shipper-carrier agreements in the private sector.

There have been agreements on Ex parte No. 445 with the NIT League, with the Chemical Manufacturers Association, and with the National Feed & Grain Association which I have just mentioned. So to say that the shipper community is sitting out there having a tirade about what has been going on with the implementation of Staggers is simply not so.

The Chairman. Thank you, Mr. Chairman.

Senator Pressler. Senator Ford.

Senator Ford. I think Senator Rockefeller is first.

Senator Rockefeller. Mr. Chairman, your term expires when?

Mr. Taylor. My term—actually, it is not a question of my term expiring. Senator. My seat self-destructs at the end of the year. So I will be leaving the Commission at the end of the year. The Com-

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mission will go down to five. Commissioner Strenio will also be leaving the Commission at the end of the year.

Senator Rockefeller. So the Commissioners go from seven to five.

Mr. Taylor. It goes from seven to five; that is correct.

Senator Rockefeller. I agree very much with the Chairman of the Commerce Committee in the statement in his resolution, that in Congress we expect that all of the goals of the Staggers Act are to be met. In other words, nobody here is trying to reregulate. Nobody is trying to do that.

What we are trying to do is to attack certain problems: Market dominance, revenue adequacy, rate reasonableness, burden of proof, things of this sort. In other words, in specific areas, we want to tinker with the Act to try to bring equity and fairness and job possibilities—in the judgment of those of us from coal States—to the Staggers Act, a Staggers Act which has indeed brought back much health to the rail industry and which has done some remarkable things.

So I think we should be very clear on that. Those of us who raise questions are not raising questions about the fundamental purposes of the Staggers Act, but only with respect to market dominance, captive shippers, things of that sort, about which there are differences.

So therefore, the Commission itself is important. You say, let the Commission do it—don't let us do it, let the Commission do it. However, you are leaving, and you have dissented a good number of times.

Mr. Taylor. Yes, I have.

Senator Rockefeller. You dissented in *Mid-Tech* and a number of other cases—we might discuss that in a moment. I don't know Commissioner Strenio, but he is also leaving, and so it does not make a whole lot of sense for me to get to know him really well.

Mr. Strenio. I hope you would find it worthwhile to get to know me regardless, Senator.

Senator Rockefeller. The probable next chairperson is a former Burlington Northern employee; is that not correct?

Mr. Taylor. Well, I have no idea who the next chairman——

Senator Rockefeller. Oh, yes you do.

Mr. Taylor. No, I really, honestly don't. All three of my Republican colleagues are actively campaigning; all three have their hats in the ring, and I don't know how it is going to come out.

Senator Rockefeller. Then let me just say, is not Heather Gradison a former Burlington Northern employee?

Mr. Taylor. Norfolk Southern.

Senator Rockefeller. A Norfolk Southern employee—that is a railroad.

Mr. Taylor. That is a railroad.

Senator Rockefeller. And Commissioner Sterrett was formerly with the U.S. Railway Administration.

Mr. Taylor. That is correct.

Senator Rockefeller. And Commissioner Andre was with the trucking industry.

Mr. Taylor. That was essentially his background. He was with the Indiana commission.

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Senator **Rockefeller**. That sounds like a break, until I realize that Norfolk Southern recently purchased North American Van Lines.

Mr. **Taylor**. That is correct; they did.

Senator **Rockefeller**. Yes; so that is three out of the five votes right there. Now, I am just going on your statement: "Let the Commission handle it; don't let the legislature or the Congress get in the way of this; don't reregulate; let the Commission handle it."

Now, beyond that, there is a labor lawyer in Nevada.

Mr. **Taylor**. That is Commissioner Lamboley.

Senator **Rockefeller**. And Commissioner Simmons who was formerly with Hess Oil and with Secretary Watt.

Mr. **Taylor**. That is correct. That is the cast.

Senator **Rockefeller**. No; I conclude nothing from that. What I do conclude is that there is a strong potential for three votes which are not automatically going to be based upon balance, without any disrepect to any of the members. I simply want to put that on the record, responding to your statement: "Let the Commission provide the fairness."

Mr. **Taylor**. Could I just say something about that?

Senator **Rockefeller**. Of course.

Mr. **Taylor**. There are a couple of points I think that are important. My dissents are not a secret. I dissented in the *Export Coal* case, I dissented in the *Boxcar* case. I know there are some things that went on at the Commission that I personally would have liked to have seen done differently.

But I think during the last year or year and a half, we have gone a long, long, long way toward setting the direction, charting the course, steering this thing in the manner in which it ought to go.

For one thing, we have stimulated a number of these private sector initiatives and agreements between shippers and carriers, and I must say that most all of those actions, with a couple of little exceptions here and there, have been unanimous decisions by this Commission. I cannot believe, regardless of what the ultimate makeup of the agency is that the tools is which this Commission has crafted to hopefully use are going to simply be left to gather dust in a tool box. I have to believe that they are really going to somehow or another be used.

But my suggestion to all of you is, why don't you wait and see? You don't have to give them forever. We have a new ballgame going now. I testified the other day in front of the House Judiciary Committee on the Seiberling-DeConcini legislation insofar as compulsory trackage rights are concerned, and I tried to give them the same message.

This NIT league group that came in to see me said that is what they were prepared to do; that they were prepared to watch and see. I even had a coal man from the Western part of the country, not from your part of the country, who said we are going to see what happens with Ex parte No. 347 and how it is handled; and if things don't come out the way we hope they will, if the direction we have set and the course we have charted somehow isn't followed, there is always time to get into a legislative reaction.

But I would hate to see it at this juncture—because I think it is—and I don't mean this in any disrespect to Congress—very diffi-

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cult for Congress to act with a scalpel. Usually it is with a meat ax. And I would hate to see Staggers get carved up because it has been, on balance, a good piece of legislation. And what it calls for itself is a balance between shipper interests and carrier interests, and that is a difficult thing to strike.

Senator ROCKEFELLER. Mr. Chairman, I agree with your thrust. I am also aware that you are eating into my questioning time.

Mr. TAYLOR. I am sorry. I didn't mean to do that.

Senator ROCKEFELLER. I know that you didn't, and I also respect much of the work that you have done. I mean, part of my concern is that you are leaving.

How many railroads are revenue inadequate under the formula set by this improved ICC?

Mr. TAYLOR. When I first came to the ICC, I think we had three or four that were revenue adequate. But we determine this every year, and let me, if I might, just quickly have him tell you what the current standard is and how many are there.

Senator ROCKEFELLER. I don't want the standard; I just want the number.

Mr. YOUNG. Today, there are no railroads who are revenue adequate.

Senator ROCKEFELLER. How many of those railroads that are not revenue adequate have triple B bond ratings?

Mr. YOUNG. I don't have that information with me.

Senator ROCKEFELLER. Could you get that for me?

Mr. YOUNG. Yes, I can.[1]

Senator ROCKEFELLER. I think you will find most of them do.

Would I be found revenue adequate under ICC standards?

Mr. YOUNG. I will defer to the Chairman on that one.

Mr. TAYLOR. I certainly hope so, Senator.

Senator FORD. I don't know, but he is a soft touch.

Senator ROCKEFELLER. Mr. Chairman, now you have passed out this sheet which I was given when I came back from my vote.

Mr. TAYLOR. Oh, good.

Senator ROCKEFELLER. It indicates that the rates really have not gone up much above inflation—there is kind of a consistency there.

Mr. TAYLOR. What it endeavors to show is that if you go back to 1979, rates went up rather dramatically before Staggers. But when we get to the Staggers Act, but for the first year in 1981, that began to level off, and rates really have moved with the inflation index, and what has really happened after 1981, because there wasn't much contracting in 1981, and contracting rates are built into these numbers, is that rates begin to move along at a rather level keel.

And the reason I point this out is because I think there are some who are very anxious to know what has happened to rates after Staggers, and I think this, which is prepared by the Bureau of Labor Statistics, is one picture worth 10,000 words and gives a better analysis of that.

Senator ROCKEFELLER. But, with an exception, it does not relate to costs. For example, over the last 10 years or so—and granted, this goes before this chart—coal-receiving utilities have increased the number of coal hopper cars by about 10 times. So that is decreased cost to railroads.

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[1] See p. 406.

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As of 1983, utilities owned more than 33,000 coal cars, coal railroad cars, which mean decreased cost to railroads. They also have made a substantial investment in terminal facilities.

Now, don't you honestly think that this has to have an effect on cost? Now, I am neither a mathematician nor a wizard, but I think this chart reflects rates and inflation, but I don't think it reflects costs, which I think is the only measure when you are really looking at—when you are trying to say that rates have not gone up that much. Part of it has to be the relationship between the rate and the costs of the railroad.

I think that the costs have risen much more slowly than the rates, and I would suggest that your real line is somewhere in here, and that the difference between the two is sheer profit.

Mr. Taylor. I would be glad to have our people endeavor to analyze that and see what we can do for you.

Senator Rockefeller. Could we have some reflections from the ICC for the record[2] on the effect of cost reduction and efficiencies that have lowered the costs to the railroad.

Mr. Taylor. Most certainly, because that has been one of the benefits of Staggers, and we will endeavor to put that together for you, Senator.

Senator Rockefeller. All right.

Just again for the record, if Norfolk Southern is revenue inadequate, how do you explain its ability to make or attempt nearly a $2 billion acquisition program, including $1.2 billion for Conrail, since 1980, since Staggers, and, at the same time, to reduce their internal debt, I am told, from about $1½ billion to less than $800 million?

Now, if they are revenue inadequate, as they are under the improved ICC's definition, how can they do that?

Mr. Taylor. Well, as I said before, the problem is with the term "revenue inadequate." It is not intended to imply that the Norfolk Southern is on the brink of bankruptcy or that it is facing financial disaster. The Norfolk Southern is doing very, very well and it has been able to accumulate a tremendous amount of cash.

But what we are talking about in terms of our standard is not short-term cash flow; we are talking about long-term financial viability. And the Norfolk Southern has come a long, long way out of the well, a lot farther than some of the others, by our standard in terms of fixing what long-term financial viability is all about. But what all we are saying is that Norfolk Southern has not quite gotten there yet. It does not imply, by having said that, that Norfolk Southern is teetering on the brink of financial disaster, because we know it isn't.

And I agree with you; we have had this problem with DOT coming up and saying, yes, they have deep pockets; they are the party to buy Conrail; and yet the ICC says they are revenue inadequate. The problem is, to me, more than anything else, a matter of semantics because revenue adequacy or, more particularly, revenue inadequacy is really a very, very unfortunate term.

Senator Rockefeller. You know, the problem to me—and then I will cease, Mr. Chairman, because I know I am beyond my time—the problem to me is not the definition of terms. It is not whether you use the word "revenue adequate" or "inadequate," or change it to make it some more dispassionate word. It is the fact that, very clearly, anyone who lives in the coal fields of this country understands that railroads dictate price. Railroads dictate price. And there would be very few people who would argue that if the Staggers Act, on those particular sections to which we are addressing ourselves—market dominance, captive shippers, rate reasonableness, and so on—were enforced properly by the ICC, as they were required to be under the Staggers Act, the cost of transporting coal would decrease by $2, $3, $4, $5, $6, $7, $8 a ton.

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[2] See p. 406.

And I am not saying that the reason that thousands and thousands of coal miners across Appalachia are out of work is only because of railroad costs, but is partly because of railroad costs. In fact, if you are talking $3, $4, $5, $6, $7, $8 a ton, that is quite a big part of the reason for our noncompetitive status.

Yes, the strong dollar is there; yes, the glut is there; yes, there are a lot of other things there. But part of the equation is the fact that railroad costs are high. Railroad costs are high because there is only one railroad—a captive situation—only one railroad serving one coal miner, one shipper. And surely you must understand that that is a fact. Surely the ICC must understand that it is causing hardship by not forcing some of these rates or causing some of these rates to go down.

I intervened in a case, as Governor of West Virginia, between Norfolk Southern and the New England Electric Power System, and it took me months and months and months of what I would consider political badgering on my part to force down a price so that West Virginia could keep a coal contract with the New England Electric Power System, which wanted to keep it with us. And I think, had it not been for the fact that I was a governor exercising some political power and was prepared to be very angry about it—and was indeed—I don't think that price would have come down.

Mr. TAYLOR. I know your interest, Senator. I remember a 4½-page letter you wrote to me which was very scholarly and well-done, and so I know of your concern.

We will see what we can do to develop that cost information for you.

Senator PRESSLER. Senator Kassebaum.

Senator ROCKEFELLER. We need your help.

Mr. TAYLOR. We will try and give it you.

Senator KASSEBAUM. Thank you, Mr. Chairman.

Chairman Taylor, let me say I have very much appreciated your efforts to address all of our concerns in different areas in which we have approached you. I particularly was appreciative of your coming to Kansas to be a part of a hearing in the fall of 1983 on the problems that smaller shippers are facing, particularly regarding the ability to be competitive and the whole question of contract disclosure

I would like to just ask if I might—and I know that it is something that you have tried to address—do you feel that the Commission requirements today are adequate? And if I may just refer to a statement from you at that hearing, in which you said that you would find unreasonable discrimination of destructive competitive practices and so forth, would be totally meaningless if all the applicable rates and charges are not set out in the contract summary. Without this itemization, a complainant cannot determine whether a necessary factor for unreasonable discrimination in rate disparities exist, or whether there are specific grounds to assert that the contract constitutes a destructive competitive practice.

In light of that, I just wondered if you felt that the current disclosure rules did provide enough information.

Mr. **Taylor**. Well, I will have to explain a little of the background on that, Senator, which, I know, you are, particularly well aware of. We have in the statute this matter of contract disclosure and the special complaint rights that pertain to agricultural shippers and forest products and paper shippers, some special rights, as you have mentioned, with respect to destructive competitive practices and discrimination.

Unfortunately, the statute—which I guess involves a piece that came from the Senate and a piece from the House that were simply stuck together—talks about revealing the essential terms on the one hand and maintaining confidentiality on the other.

It has been a terribly difficult thing for us to work with. I felt in the beginning when the first decision was issued—and I dissented, as a matter of fact, in that matter—that you could not really have the essential terms known and revealed if the actual price was not revealed.

Well, I did not prevail on that. It went up to the second circuit. And what the second circuit did when they sent it back was to say we will buy off on that, but we think you better do something more important about discovery, and that maybe the so-called second tier approach is the way to make these two conflicting provisions in the contract section actually live with each other.

If a shipper can have, through discovery, an opportunity to really get at the information he needs to exercise his special statutory complaint privileges, and if, at the same time, the results of that discovery can be maintained in a confidential fashion so as to protect the railroads' interests, maybe we have arrived at some way to make this statutory provision actually work.

What we did was to then adopt some interim rules, and those have been in place. Where we are today is that we were about to adopt final rules on discovery in October, when we were advised at the 11th hour that the National Feed & Grain Association had worked out an independent agreement with the AAR and that, presumably, will be presented to us sometime next week. We are delighted about that result because I think if this discovery is satisfactorily resolved so that a shipper can get the information that it really needs, without having to prove a prima facie case up front, and at the same time not be allowed to conduct a fishing expedition, we will have really been able to lick this contract discovery problem that I know you particularly have been so concerned about.

Senator **Kassebaum**. Well, I know that there is an effort to work out a compromise, and I would agree with your early comments to Senator Danforth, because I know there are a number of us here who, as you know, are concerned with this problem but who believe that it is best if it is handled in that arena, rather than us trying to construct a legislative answer.

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But Mr. Fitzgerald will be testifying later this morning on a study done in Kansas for the Department of Agriculture which shows that actually there has been, for those shippers with contracts, about a 17-percent advantage, price advantage, compared to the tariff rates.

Mr. **Taylor**. That is correct, Senator, and it was done just on Kansas.

Senator **Kassebaum**. However, small single location shippers generally are not participants in contract ratemaking. Now, maybe the day of the small single location shipper is over, just as we are facing a number of dislocations in our farm communities, in the farm economy.

But I hesitate to write that off at this point unless we have made absolutely sure, and with a lot of certainty, that there has been the ability to participate. And I think that since I don't know what the compromise is that has been worked out, or in general how much the individual feed and grain associations will be supportive, I suppose it is an open question how well it worked.

But I still think there are some problems for the smaller shipper.

Mr. **Taylor**. Well, I think you may be right, but I think the interesting thing that is happening with grain, and has particularly happened here quite recently, is that the number of grain contracts has risen dramatically in late 1984 and 1985. About 25 percent of the contracts that we receive now are grain contracts.

And I think it is amazing that 41 percent of the grain that is moving is moving under contract. A lot of people thought that would never happen. Now, the extent to which this involves big shippers or little shippers is very, very difficult for us to determine.

Senator **Kassebaum**. Well, that is what I was going to ask.

Do you have any way of knowing sizes of shippers, because the contracts have increased substantially?

Mr. **Taylor**. I know that Senator Pressler is interested in this question as well, as to what is a big shipper. Of course, you have to have a definition first. We have had some discussion with his staff about it.

Let me turn this over to Bill Southard, because we are going to try and develop——

Senator **Kassebaum**. I don't want to be redundant if you have already covered this.

Mr. **Taylor**. No; we have just talked to Senator Pressler's staff about this same area of interest. So Bill is going to endeavor to respond. What can you tell us?

Mr. **Southard**. Senator, all I wanted to say was that in response to Senator Pressler's concerns, my staff has started to work to identify for South Dakota, the west, the breakdown between large shippers and small shippers. We have also identified simply the number of contracts involving South Dakota and surrounding States, which Kansas does not touch.

But we are looking at the question. I would be happy to expand it to look at Kansas small shipper/large shipper breakdown, too. I believe that was done, though, by Agriculture.

Senator **Kassebaum**. I think we may want to sort of expand or revisit this after we see what the compromise will be perhaps that is being put forward now.

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Mr. TAYLOR. We should have that next week, we have been told.

Senator KASSEBAUM. Thank you.

Senator GORE. Mr. Chairman, could I briefly ask unanimous consent to put an opening statement in the record?

Senator PRESSLER. Without objection, so ordered.

[The statement follows:]

OPENING STATEMENT BY SENATOR GORE

Mr. Chairman, the implementation of the Staggers Act is an important issue for shippers and communities and railroads in Tennessee, and I want to congratulate you and the subcommittee for holding these hearings.

I am a cosponsor of the Consumer Rail Equity Act now pending before this committee. I know the bill is controversial, that the railroads and the largest shippers, who have enjoyed the benefits of Staggers, oppose the legislation. These hearings will go a long way toward defining the need for revisions to the Staggers Act. The question is relatively simple: who are the winners under Staggers, and who are the losers? I believe the answer to this question will guide the Committee in its deliberations about legislation.

During 1978 and 1979 I participated in House Commerce oversight hearings on the alarming rail transportations rates being charged to captive coal and grain shippers. We found disturbing evidence that railroads were slapping 200, 300, and 400 percent increases in these rates almost overnight. In Tennessee, the L&N Railroad had announced four-fold increases in coal transportation rates to TVA power plants which were captive to the L&N. This situation was even worse in the case of Texas utilities dealing with the Burlington and Northern Railroad, because they did not have the marketplace leverage of TVA and its large volume orders.

And, of course, this rate gouging of captive shippers was occuring even before passage of the Staggers Act, which gave the railroads broad new powers to charge whatever they chose to their shippers.

Where was the Interstate Commerce Commission during that pre-Staggers period? We found during the House oversight hearings that not only was the ICC unwilling to vigorously enforce the regulations then on the books, but that it was virtually incapable of doing so. The agency was using accounting methods and standards that were 30 years old. Consequently, shippers trying to challenge dramatic rate increases could not obtain the information or assistance from the ICC to effectively state their case.

In the instance of rail line abandonments, shippers and their communities were unable to prepare cases which would deny wholesales abandonments, thus giving railroads a blank check to eliminate vital freight service, especially to small towns and rural areas.

So, while captive shippers and communities and shippers threatened with abandonments were theoretically protected by regulations, and while the ICC was theoretically representing the public interest in these cases, in fact, the railroads controlled the process.

And, as I said, that was before Staggers, before railroads were unleashed to apply "new competitive practices." Mr. Chairman, we suspected then, and we know now that "new competitive practices" are little more than holding captive shippers hostage to higher and higher shipping costs and dropping thousands of miles of service that these huge corporate holding companies determine to be less profitable than desired. In the case of utility shippers, those unchecked charges have amounted to billions in unjust electricity rate increases throughout the country. In the case of abandonments, there are no longer any protections for rural communities trying to keep their economies afloat in difficult times.

I am not insensitive to the financial problems which faced the railroads during the 1970's, when bankruptcies were being filed almost daily. The railroads had a problem, and they have boldly solved it, in large part through huge mergers that have reduced the number of carriers to a handful.

These newly merged corporations, usually controlled by holding companies with many varied kinds of business ventures in addition to railroads, have placed new demands for profitability on their railroad properties. Consequently, the term "rate of return" has taken on new meaning when assessing the revenue needs of the railroads.

I believe the subcommittee should ask several questions of the ICC and the railroads: To what extent are these holding companies syphoning off railroad profits to pay dividends to offset losses in other enterprises? When the railroad demands an

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increase in captive shipper rates, does it reflect the railroad's costs, or does it simply reflect the holding company's demands for higher and higher profits from those customers with no choice? Does the ICC have the tools necessary to protect the public interest in rate and abandonment cases? And if it does, is it using them?

I am sure that these hearings will provide a thorough examination of the issues confronting the railroads and shippers since the passage of Staggers. I want to take a few moments to explain to the subcommittee the problem of abandonments as we have experienced in Tennessee, and offer some modest solutions.

Since 1976, there have been 30 stretches of railroad abandoned in the State of Tennessee. Of those, only six have been able to continue service with a short line operation. For 24 other areas, rail service has been permanently lost; and for many counties, cities and towns the loss has been economically devastating. Later this month, the Chessie-Seaboard System (CSX) will file its application to abandon 108 miles of rail line through three Tennessee counties and 21 communities. This move will have a direct impact on 53 companies which ship on the line, hundreds of employees and their families, and ultimately all 120,000 Tennesseans who live in the affected area.

A railroad is more than a convenience. Often, it is the economic lifeblood of a community, especially small and medium-sized cities. To a shipper which provides local jobs, a rail abandonment may mean shutting down, moving that plant elsewhere, and taking the jobs with it. This has occurred many times in Tennessee, and the abandonment procedure needs close scrutiny and modifications to prevent further economic chaos.

Deregulation gave the railroads broad new powers to abandon lines. Instead of making the railroad prove the reasonableness of any proposed abandonment, the burden of proof has been shifted to the shippers and local communities. Instead of serving as a forceful watchdog of the public interest in abandonment proceedings, the ICC has become little more than a rubber stamp for the desires of the railroads. There has been a rapid push to abandon rail freight service in rural areas of Tennessee and other states. CSX, which I previously mentioned, has been particularly aggressive in dropping out of Tennessee communities. Economic priorities are cited, but the monopoly position of railroads like CSX has changed little in rural Tennessee and throughout the country. Many shippers are still captive, with no competing carriers to move their goods.

The railroads have been given great freedom to compete; but where competition is not possible, they must be required to meet their responsibilities. Wholesale abandonment of freight service is not only undesirable, it is unacceptable.

I am convinced that a careful evaluation of the abandonment process, with attention to actual cases in Tennessee and elsewhere, will reveal the need for modifications of law and procedure to better protect the public interest. The ICC can and should play an effective role in preventing many now-routinely-approved abandonments. Legislation is one way to put teeth back into the ICC's role in this process.

If the purpose of deregulation has been to enhance competition, the effect has sometimes been just the opposite. CSX recently tried to abandon the railroad track segment from Lawrenceburg, Tennessee, to Florence, Alabama. That abandonment would have left the City of Florence with rail service by the Southern Railway only. That service is to the south of that city and requires movement across a bridge at the Tennessee River with severe weight restrictions. Several other towns in Tennessee and Alabama would have been without rail service altogether. The protest against that abandonment was successful, but it was—unfortunately—the only successful abandonment protest to occur in the entire region.

More typical is the case of Grundy County, Tennessee, which has lost its rail service permanently between the cities of Cowan and Tracy City. Grundy County was already economically depressed, with an unemployment rate in the last reporting period of 18.8 percent. On Monday morning, workers will begin tearing up the rails and ties between those two cities. The rights-of-way and the physical means of establishing a rail link there are gone forever; and any hopes of attracting new industries, better jobs and long-range opportunities for the local population are severely crippled.

Opposition to this particular abandonment was strong, but it lacked the expertise necessary to battle a giant corporation like CSX. And the procedure, while well-defined, is sometimes confusing. By law, the ICC must find that "the present or future public convenience and necessity require or permit" the abandonment. Yet the basis for making that determination is a cost analysis prepared by the railroad and an abandonment application which may contain pages upon pages of almost incomprehensible figures, tables, charts, and graphs. Much of that data is of dubious importance, and it seems clear that it is often presented in a manner designed to cloud the issues involved.

As for the financial statement outlining the carrier's status, there is a near certainty that the accounting techniques utilized by the railroad will totally support its desire to abandon the line. One badly-needed change in abandonment procedure is the requirement of an independent appraisal of the cost and revenues of any given line and the financial situation of the carrier.

In deciding if an abandonment is approved, the ICC is charged with balancing the interests of the local community and shippers against the broader public interest in freeing railroads from burdens which may harm their overall financial health and their ability to operate elsewhere. But the ICC—in practice if not in theory—has given overwhelming preference to the desires of the railroads rather than to those of the communities and shippers. A huge majority of abandonment applications, including those seriously and vigorously opposed, are approved by the ICC. This occurs even though the only specific factor listed in the Interstate Commerce Act to weigh is whether the abandonment "will have a serious adverse impact on rural and community development."

This is the single most troubling aspect of the abandonment procedure as it now operates. No one can deny the importance of rail service to any community that hopes to attract new industry, or even to maintain and expand its existing industries. Agriculture, so vital to America's rural economy, is also affected. Many jobs are directly lost because of an abandonment, but many more might never come into existence.

So a much greater emphasis on the economic and social impact of abandonment must be taken into account by the ICC. For Grundy County, it is too late. Perhaps the railroad was correct, and there was no economical way for that particular line to keep operating. But we can be certain that under the current abandonment system, the long range needs of the people of that area were not given adequate consideration.

For the 108-mile rail line between Monterey and Donelson, Tennessee, which I mentioned at the opening of my statement, it is not too late for a proper balance in the abondonment process. I confess to a particular interest in that line, since it runs through my own home town of Carthage. CSX has allowed that line to deteriorate; this in turn caused some shippers to try to find alternatives; then the railroad used the poor condition of the line and the decline in business as an excuse to abandon the line. Now the cost of rehabilitation is estimated at about $2.5 million.

The economic impact of the loss of rail service to these three Tennessee counties will be severe. As many as 150 jobs may be directly lost. The executive director of the Chamber of Commerce in Cookeville, Tennessee, has indicated that 900 jobs have already been lost just because of CSX's announcement that it intends to abandon the line. Other lost investments can be expected as well. In Monterey, Tennessee, 65 jobs and one of the oldest and most important businesses in that town may well disappear altogether if this abandonment takes place. The potential for the expansion of the industrial base in Wilson, Smith and Putnam Counties will be severely impaired if rail service cannot be retained.

These factors need to be taken into account when this abandonment is considered. More than that, they need to be given a great deal of weight before the application is approved. This case is not an exception, it is common throughout the nation. Soon, rail service in another part of Tennessee between Dechard and Fayetteville will be proposed for abandonment. I want the people there to have confidence that their needs, their jobs, their futures, and economic opportunities for their children will be given the attention they deserve from the ICC. Every American deserves the same consideration, and we can in good conscience offer them nothing less.

Most rail abandonment applications at the Interstate Commerce Commission are unoppoesd and have only token oppostion, and the ICC quickly grants permission to abandon the line. Even abandonments seriously and vigorously opposed, however, are overwhelmingly approved by the ICC. Only occasionally do shippers and community leaders succeed in defeating an application for abandonment.

By law, the ICC must find that "the present or future public conveninece and necessity require or permit" the abandonment. The first step by the rail company involved is usually to place the line in "Category 1." that is, "subject to abandonment." There is no requirement that the line first be listed in "Category 2", that is, "potentially subject to abandonment," and most railroads do not use that category at all.

Perhaps we should require the use of Category 2, lengthening the abandonment process, and giving communities and shippers the opportunity to formalize their ac-

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tivities concerning the abandonment. Those activities would include preparing a case to present to the ICC to fight abandonment.

After the line has been in Category 1 for at least four months, and following the publication of a notice of intent to abandon the line, the formal application can be filed. The ICC requires a carrier to include in that application much information about cost and revenues on the line and the overall financial situation of the carrier. This presents the carrier with an opportunity to muddy the waters, to becloud the facts in its own favor. Abandonment applications may contain pages upon pages of almost incomprehensible figures, tables, charts, and graphs. Much of that data is of dubious importance, and it seems clear that it is often presented in a manner designed to obfuscate.

The ICC should more closely regulate what can be included in an application, and even send back applications to abandon a line if they are not prepared in a manner understandable not only to the ICC, but to the local governments and the business people who will be directly affected by the abandonment.

As for the financial statement outlining the carrier's status, there is also the near certainty that the accounting techniques utilized by the railroad will totally support its desire to abandon the line.

Companies should no longer be allowed to provide their own financial appraisals. An independent appraisal should be required of an institution approved by the ICC and paid by the carrier.

A railroad may request the waiver of certain information normally required in the application. Often, the railroad, seeks to exclude data concerning overhead costs or bridge traffic if that traffic would be retained by the railroad using other routes. The ICC usually grants this type of waiver, and some flexibility is reasonable to meet the circumstances of the particular line involved. But relevant information can be, and sometimes is, left out.

We should insist that the ICC tighten the policy on information waivers, requiring a detailed request for such a waiver, and a closer assessment of how that waiver would alter the overall financial statement.

After an application to abandon has been filed, protests may be submitted and the ICC must decide in 45 days if an investigation should be instituted. Three factors seem to weigh heavily in the ICC's determination to investigate: the amount of opposition, the intensity of the protests, and opposition from elected officials. If an investigation is instituted, there will be either an oral (field) hearing or "modified procedure." The latter means that all evidence and testimony is submitted in writing, and this is most often the course of action.

In deciding if an abandonment is approved, the ICC is charged with balancing the interests of the local community and shippers against the broader public interest in freeing railroads from burdens which may harm their overall financial health and ability to operate elsewhere. As has already been noted, the ICC—in practice if not in theory—has given overwhelming preference to the desires of the railroads rather than to those of the communities and shippers. It should be noted that the only specific factor listed in the Interstate Commerce Act to weigh is whether the abandonment "will have a serious adverse impact on rural and community development."

This is the single most troubling aspect of the abandonment procedure as it now operates. No one can deny the importance of rail service to any community that hopes to attract new industry, or even to maintain and expand its existing industries. Agriculture is also affected. Hundreds of jobs are directly involved, and thousands more might never come into existence. For these reasons, a rail abandonment is an intensely serious move—one which can have a devastating impact on the economic health of a city, town or county and the people who live in it.

The ICC should change the formula in consideration of abandonment, with a greater emphasis on the economic and social impact abandonment would have on the communities involved. Like the previous suggestion for change (on waivers) this is a judgmental decision. It is hard to write into law, and would best be implemented by an attitudinal change on the ICC. Barring that, a "point system" perhaps or some other legislative/administrative device might be put into place.

The railroad has the responsibility of establishing that it is suffering a loss or burden, but an actual "operating" loss does not have to be demonstrated. The ICC allows the railroad to calculate what it known as the "opportunity cost" of owning and operating the line—that it, the cost to the railroad of tying up its assets in track, land, and equipment on a line it wishes to abandon.

Affording less weight to the "opportunity costs" is a possibility for another suggestion for change. The problem with doing so relates to the reason the rail line might be considered for abandonment in the first place. Railroads have allowed lines to deteriorate; this in turn causes shippers to turn to alternatives; the rail-

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roads use the poor condition of the line and the decline in business as an excuse to abandon the line. Such a "Catch 22" situation is a direct result of deregulation. Limiting "opportunity cost" might only serve to motivate the railroads to allow an even greater deterioration of lines they do not wish to keep.

Also to be considered are: alternative transportation and its costs, the effect of past business fluctuations, and anticipated increases in rail shipments. Not only must protestors demonstrate the harm they will suffer, they must also disprove or at least question the railroad's evidence. This is difficult since operating expense, rehabilitation and maintenance costs, and liquidation values are all open to interpretation. These difficulties could be addressed with the above-made suggestions on changing the weight given to local damages and requiring an independent appraisal.

Once a decision is made to abandon the line, the communities and shippers may decide to set up a "short line" operation. This effort is only occasionally successful, and some suggestions can be made to help a short line succeed.

Federal rules should prohibit the railroad from taking up the rails and ties from an abandoned line right away. The rails and ties are used in other parts of the line or for salvage value. When this occurs, the abandonment is irreversable: rights-of-way are lost, and the physical means of setting up a railroad have disappeared. There needs to be a reasonable amount of time to allow the communities to find an alternative rail service.

The ICC should require the primary shipper to divide rates with a short line operation that takes over an abandoned line. There is now no such requirement; although the railroad often does this as an incentive to the short lines, since the short lines do generate business for the primary shipper.

We should give the ICC the option of requiring the railroad to sell more of the line than was orginally proposed for abandonment at actual value. In the theoretical case of a 100-mile spur, if the railroad proposes 50 miles of it for abandonment, the reason must be that the first 50 miles operates at a profit. If all or part of the first 50 miles could go to a short line operation, it could subsidize the remainder of the line. There would be greater chance that the entire short line could operate profitably.

Senator PRESSLER. Senator Ford.

Senator FORD. Thank you, Mr. Chairman.

Chairman Taylor, you give me the impression that the Staggers Act has taken on the cloak of the Holy Grail.

Mr. TAYLOR. I hope I didn't do that.

Senator FORD. Well, it is the greatest thing since peanut butter, listening to you.

But the whole point of those who are vitally concerned with what is happening in the Commission and under the Staggers Act is that where there is no competition, we have trouble. And it does not take a mental giant to understand that.

Now, you rolled off all of these issues on which the Commission has made a decision, but only recently in the Appropriations Committee, you know, there was a big argument about whether you all ever met or not. Are you all now meeting?

Mr. TAYLOR. Oh, we most certainly are. We have had more collegiality going on in the sunshine than any other agency in town of late. I have got some numbers on that we can give you if you would like.

Senator FORD. I have never seen anybody who so often doesn't bring anything with him, but can give it to us when we want it. With all those big books and support maybe we can find the answer.

I have a question with two parts. (A) I want to know what the thought process was behind the stand-alone decision. What really generated, what conjured up the idea that a captive shipper would have to build its own railroad?

(B) You were chairman of the public service commission in Nevada.

Mr. **Taylor**. That is right. For 4 years.

Senator **Ford**. Wonderful. Did you ever use that formula in Nevada?

Mr. **Taylor**. No, we did not.

Senator **Ford**. OK, now give me the thought process. That will be intriguing, I think, to all of us.

Mr. **Taylor**. Well, I am going to ask, if I may with your permission, to have Director Young speak to this as well. But I think the important thing to say at the outset is that stand-alone cost is only one of four constraints, and they are all intended to work together, and they are all intended to interrelate.

And the other important thing, I think, that I should say at the outset is that stand-alone cost does not entail the cost of somebody going out and building a gold gilt railroad or a coal slurry pipeline or something else. What we are talking about is—and the shipper has the opportunity to lay it out in whatever efficient manner he wants—what a hypothetical, efficient competitor would charge. That is the theory that we are talking about.

Senator **Ford**. To get back to Senator Rockefeller's statement a while ago, these poor shippers out there are buying their own cars as far as the coal field is concerned. They get a few cents per mile back. But then if they don't need their car, you find it on a side track down in Georgia somewhere.

They have to buy an old locomotive which they are able to get, and they go down and pick up the unit train with their cars on it, bring it up, load it, and take it back to the railroad.

Now, they are being at least somewhat efficient by having a locomotive, buying the cars, and being able to hook onto them and load them and take them back to their destination point.

Now, there is something to that, and I don't know whether you ever factor any of that into your consideration of a captive shipper. That is in addition to having the high rate. So let me hear the other——

Mr. **Taylor**. Let me ask Director Young if he might, please, just give you a little background.

Mr. **Young**. Senator, let me give you a little bit of perspective on this so that you can understand the thought process that we went through and how we got to where we are in the Ex parte No. 347 guidelines, stand-alone cost in particular.

The Commission has been dealing with finding how to find when a rate becomes unreasonable for approximately 10 years, and they have been very unsuccessful. Every attempt that they have used over the last 10 years has failed.

Back in about 1975 or 1976, they tried using what was called a fully allocated cost approach which is an accounting methodology where you allocate costs. That methodology was employed, and it was found that it was not really assisting the railroads to improve their profitability. So at that time, the Commission then decided to look for another approach.

They then proposed a method called the 7-percent solution. That method was an attempt at differential pricing. What they did there was, they used the fully allocated cost approach and then they said, well, the railroads need a little bit more to become or move toward revenue adequacy in order to differentially price, so what we should do is allow them to price somewhat above that figure.

And they were trying to find out how high that number should be and, quite arbitraily, they picked a number which was 7 percent.

That decision went to court and the court threw it out because it was arbitrary. They said you cannot just put a number on top of that. The Commission then tried another approach to come up with differential pricing, and that was called the ton-ton mile approach. And what they thought they were doing there was to allocate costs, the common and constant costs of the railroad, on the basis of long haul, heavy loaded commodities.

Senator **Ford**. Don't talk me out of question time.

Mr. **Young**. I certainly won't, but I want you to understand fully what the process was. And they found out that that was yielding very, very low rates. That was a methodology that did not work, and it was locked into the strict accounting base system.

They then proposed another approach. What happened in response to that was the railroad industry came in and they said we want Ramsey pricing, pure Ramsey pricing. Pure Ramsey pricing would, in effect, allow the railroad industry to charge rates based strictly on demand, and that was very difficult to measure.

So we thought that the concept of allowing the railroads to alter their rate structure, but to put some parameters or some constraints on it so that we can determine at what point a rate does become unreasonable, that that might work and that would be based on sound economic principles.

Well, we put that proposal out and we adopted stand-alone cost which is an economic concept. And basically what it is is as the Chairman described. It is the cost that a hypothetical efficient competitor would pay if he had to build a similar system, but it takes into account not just that particular shipper, but all the shippers who might utilize that system as well, which has not been really understood, because we really have not employed the methodology yet.

The other constraints with stand-alone cost are revenue adequacy and we have also put some flesh on the Long-Cannon provisions in the Staggers Act which will help the shipper make his case under that constraint. So you have got those three constraints working together.

Senator **Ford**. Mr. Chairman, it appears that up front he said—and I think I understood him—the thought process behind this stand-alone procedure was to improve the profits of the railroads. And they have been working on it for 10 years.

Turning to CARS—and I talked with them yesterday in my office—most of those shippers with CARS are in competitive areas. And most of those I talked to yesterday were huge, Fortune 500 operators that are in areas with a lot of competition. They are scattered all over the country. And they have industry and small operations in every State almost—when they want to come and see you, they have operations in your State, but they are from New York.

And I thought they were Kentuckians, you know, and so I wanted to see them. And they came in, and they have a little bit different attitude.

Mr. TAYLOR. Senator Ford, could I say that this whole business of maximum coal rate guidelines was not done with the idea of holding rail coal rates down or suppressing rates.

Senator FORD. Look, you don't have to tell me that. They have gone through the ceiling, so you don't have to tell me the idea was to hold coal rates down.

Mr. TAYLOR. But we have a mandate from Congress to strike this balance between helping the industry achieve revenue adequacy on the one hand and trying to see that captive shippers are not charged unreasonably high rates on the other.

And what we have endeavored to do with this Ex parte No. 347 proceeding is to strike that balance. And I don't know that it is a perfect balance.

Senator FORD. Your staff over there said it was the consideration of helping railroads to improve their profit. Now, you brought up the issue of the Long-Cannon factors. What are the Long-Cannon factors that you used?

Mr. TAYLOR. We have included as one of the three constraints the matter of management efficiencies, and we have specifically put that in there because we think that is terribly important that it be recognized.

I don't know whether you know—oh, I think it was 2 or 3 years ago—we had a petition from some utilities to create a data base that annually we would consider the Long-Cannon factors when we determined revenue adequacy. And we decided not to do that; that we were going to look at that whole matter on a case-by-case basis. And what 347 does is look at it on a case-by-case basis and we have incorporated, as a part of the so-called third constraint that Director Young mentioned, the Long-Cannon factors. And that is a very important constraint.

If a shipper can come in and show, either as to pricing or as to management practices, that a railroad is not operating efficiently, that is a way for him to rebut a showing of revenue inadequacy by the railroad.

Senator FORD. Well, the Long-Cannon provisions, too, provide that no product should be required to make up a shortfall from another one, isn't that correct?

Mr. TAYLOR. That is correct.

Senator FORD. What is the percentage of coal hauled to total tonnage for most of the railroads in the East? Isn't it about 60 percent of their shipments and 40 percent of their profit.

[Pause.]

Senator FORD. Come on, let's get with it. You have it. Come on, flip that page.

Mr. TAYLOR. He is looking.

Mr. YOUNG. I can only give you a national figure. I don't have it in the East.

Senator FORD. Well, give me a national figure.

Mr. YOUNG. OK. Coal as a percentage of coal do you want, or as a percentage of total traffic?

Senator FORD. Percentage of total traffic.

Mr. Young. Coal as a percentage of total traffic nationally is 4.56 percent of the ton miles.

Senator Ford. What, then, about Appalachia? Of course, the national figure is thrown off because it includes grain and other products.

Mr. Young. I don't have it broken down.

Senator Ford. So in our area, about 60 percent of the tonnage hauled is coal and about 40 percent of the income is from hauling coal.

You said, Mr. Taylor, earlier that about 20 percent of the profit came from captive shippers; 5 to 20 percent is what you said, I think.

Mr. Taylor. It depends on what measuring stick you use. People have used different ones.

Senator Ford. I have one question left, Mr. Chairman.

Senator Pressler. We will have to move on. We are at the first witness. We will come back to you on the second round, I guess. Senator Kasten.

Senator Ford. Well, I have been here ever since this hearing started, and some of the members came in right at the tail end of the testimory.

Senator Pressler. Well, go ahead then.

Senator Ford. No, no.

Senator Pressler. I am just trying to keep the thing moving, and we have a 10-minute rule.

Senator Ford. I won't call you Packwood; I'll just call you Pressler. You go right ahead.

Senator Pressler. Senator Kasten.

Mr. Strenio. Mr. Chairman, I don't want to cut into the time here, but I may have some additional thoughts on Senator Ford's point that I would like to be able to submit later.

Senator Kasten. Thank you, Mr. Chairman.

I would like to switch gears a little bit. The last time that you appeared before us, Commissioner Gradison was with you. I questioned her at length about the whole question of the ICC's orders applied to small railroads and their shippers; the boxcar issue. I was concerned about Greenbay packaging, and I just want to follow up.

I understand that you were in the minority—that was one of the decisions that you were dissenting on, but I want you to speak for the Commission if you can today. It is my understanding that after the courts reversed your boxcar decision, the ICC essentially started all over again. Is that correct?

Mr. Taylor. We did.

Senator Kasten. What is the status of the new proceeding?

Mr. Taylor. What we are doing today really, in my view at least, is what we should have been doing way back then. First, what we did was to bifurcate the two matters. We split off car hire from the rate issue. And it seems to me that should have been done some time ago.

And as of now, the court upheld the exemption for single line rates, but it did not for joint line rates. And the joint line rates proceeding is Ex parte No. 346 (Sub-No. 8). In that (Sub-No. 8) proceeding, we have had initial comments filed, replies are due on Novem-

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ber 8, 1985, and I have scheduled that case for a public conference on December 11, 1985, so that we can decide the matter and get a decision out before the end of the year.

The car hire, car service portion, which was included and rolled up in one ball when we had the *Boxcar* case initially, is in what we call Ex parte No. 346 (Sub 19). That proceeding has been the subject of an advance notice of rulemaking, and a draft notice of proposed rulemaking has just been circulated to the Commission and, as a result, I think the actual notice on that should be issued by the middle of November.

So we are trying to make both of those proceedings move. We have a funny problem now with the single line/joint line rate issue, because you really cannot have a situation that is half regulated and half free, and that is what we have at the moment, and the industry is very concerned about that.

Senator KASTEN. Thank you.

It is my understanding that Conrail, which was, of course, a proponent of boxcar deregulation, and the short lines negotiated a compromise in the hope of avoiding further delay and also in the hope of avoiding the kind of litigation that you are talking about.

Mr. TAYLOR. They did.

Senator KASTEN. That industry compromise was submitted to the ICC, it is my understanding, 6 months ago. Now, can you explain to us why the ICC has not taken action yet with regard to that compromise, especially because it was worked out between what we viewed as the key parties.

Mr. TAYLOR. And we are delighted about that, because that is exactly what we wanted to see happen. But some other parties have also done some agreeing and some talking, and we wound up with, if I am not mistaken, about eight different proposals out of our advance notice of proposed rulemaking.

Senator KASTEN. When are you likely to act on the compromise?

Mr. TAYLOR. It is done. The proposal is now before the Commission. And, as I say, this is the first of November. By the middle of the month—it should not take us more than 2 weeks to vote on it—by the middle of the month the notice of proposed rulemaking, which—I hope I am not prejudging the thing here—will set out this Conrail agreement that you have been talking about.

We tried to put it on a fast track and make it move. We had a lot of other proposals that were given to us as well. We did not have just that one.

Senator KASTEN. As you are aware, I have joined with Senator Gorton in sponsoring proposed boxcar amendments, actually on two different bills.

Mr. TAYLOR. I am aware.

Senator KASTEN. Now, both times there was considerable support, and I would say sympathy in the Senate for the position that both you and I share. What you are saying to me now is that we probably are not going to have to renew this legislation, that you are going to be able to resolve this question. As you know, we had about 46 cosponsors, which indicates strong support. I believe we had at least 60 votes in the Senate.

Are you saying to me today that you believe the Commission is capable of resolving this issue on its own and it will do relatively quickly, or are we going to have to go back and legislate some kind of a solution to the boxcar problem?

Mr. **Taylor**. I am saying that as of now, both of these matters are on a fast track, they are both in front of us. In the car hire, car service area, which was the particularly controversial part of the boxcar decision, agreements have been reached and have been put together in the decision. It is simply a matter now to see that that is implemented. And hopefully you will not have to revisit that issue.

And I know you had a lot of support. We had over 150 letters from the House side, but I think it is being attended to now in the manner that I would have liked to have seen it attended to before. I am very pleased about that. And I would hope you would be, too.

Senator **Kasten**. I appreciate your answer and just want to restate the fact that a number of us have a keen interest in this. We think it has taken too long and we want to get this issue behind us.

Thank you, Mr. Chairman.

Senator **Pressler**. Senator Exon.

Senator **Exon**. Thank you, Mr. Chairman.

I have been listening, Mr. Taylor, with great interest to the series of questions. I take it that if nothing else has happened, you and the other Commissioners have gotten the impression this morning that there are some of us on this committee who are not totally satisified with the way that the ICC is enforcing the Staggers Act.

Mr. **Taylor**. Loud and clear, Senator.

Senator **Exon**. Is that a fair summation of what I have heard so far?

Mr. **Taylor**. Loud and clear. I wish all my colleagues were here.

Senator **Exon**. Well, I hope that all this can be taken back to your colleagues. I would like to give you, Chairman Taylor, and your colleagues who are here with you this morning, a chance to come around to our position somewhat.

It is very clear that we are not happy. We get many complaints from captive customers and consumers that they are not being treated fairly under the act, and I guess it is fair to say that I join my colleagues in not disagreeing with what you think is right, but disagreeing with the position that I think you and the other members of the Commission have taken with regard to what some of us consider to be a misinterpretation of some of the protection features in the Staggers Act.

I assume you are familiar with the fact that myself and others have introduced legislation to get this matter back in perspective and and spell out, if you will, some changes that we think are necessary.

Would you or the other Commissioners here this morning care to respond to what you see as far as the contents of the CURE bill are concerned? I suspect that you are not going to agree with the thrust of it. Maybe you do. But I suspect you will not.

I would like to have you say, though, that with the concern expressed by many members of this committee, you think it would be helpful at least to identify what the Congress wants you to do as far as protection of consumers and captive shippers under the act.

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I am asking you whether you think the CURE bill is a good bill or a bad bill? And do you specifically agree that the CURE bill at least gives us more of a leverage over the interpretation of the Staggers Act as interpreted by the ICC and over the future Commissioners and those we have right now?

Mr. TAYLOR. I would be happy to respond to that, Senator, and I had a feeling CURE was going to come up.

I know that you are on that bill, and I guess Senator Stevens who is on this committee is, and Senator Ford is, Senator Gore, Senator Rockefeller, and of course yourself. So I know the interest in this committee in that particular piece of legislation.

I guess my bottom line plea would be, again, please don't fool with Staggers now, whether it be through CURE or any other kind of legislation, until you see what happens with some of the initiatives that we have just recently implemented.

Let me just quickly, on a summary basis, indicate to you that of the six important matters that the CURE legislation deals with, we have addressed four of them. We may not have addressed them exactly as the authors of the CURE legislation would have liked, but I don't think it is fair to say that the Commission is not sympathetic with—perhaps not the mechanics of where CURE was coming from—but at least with some of the topics that you endeavor to deal with.

The first one that you endeavor to deal with is market dominance. Well, we have spent a lot of time dealing with market dominance and we have just turned out a proceeding in Ex parte No. 320 which essentially puts the burden on the railroads now to prove product and geographic competition.

Prevously, to prove that was a real run up hill for shippers. They are kind of theoretical concepts to begin with, and they are very difficult to cope with, and endless discovery went on. That is one of the reasons we had delays in these cases. And with the burden now on the railroad, we think that makes a substantial contribution to getting past this threshold market dominance determination that has to be made.

Another matter you address in the legislation is rate reasonableness. Now, you may not like what we did in Ex parte No. 347, but I know some coal people and a number of other shippers, because I think there are many who feel that perhaps those guidelines will eventually apply to other commodities—who are taking, at least for 6 months or an 8-month period, a "wait and see" attitude.

You addressed revenue adequacy in the CURE legislation. That is presently being dealt with, although maybe not exactly the way you would like. I know that you probably would like to have us consider a whole lot of other things than just the cost of capital. Some day maybe the Commission will do that. As of now, we are not playing with the concept, but we are playing with the application of the concept in a proceeding that should be out in the spring.

We have not dealt with the matter of exemptions, although we have had a number of them. And one of the big things, I would guess perhaps the biggest thing, in the CURE legislation, is competitive access. And we have dealt with that in Ex parte No. 445, and we hope that is going to work. I really think at least it should be given a chance to work.

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And the last thing you deal with is abandonments, and of course we deal with those on a case-by-case basis, rather than a rule.

What I am saying is that we think we have tried to address, as we did the matters that were raised in Senator Danforth's legislation, the concerns that were expressed, by topic anyway, in the CURE legislation.

I am not trying to use up your time, so I will shut up.

Senator Exon. You already have, but that is all right. It was a question that demanded a long answer and I appreciate—I am not sure I agree with you—but I appreciate what you are saying.

Mr. Chairman, the other Commissioner would like to say something. I am out of time. If you want to grant him some of your time, I would be happy to hear him.

Senator Pressler. Go ahead.

Mr. Strenio. I will be very brief. I just wanted to add that we have been working very hard to address the concerns that we all share about captive shippers and the other concerns that have been raised, and it is our hope that our actions will make any bill unnecessary. The point is that it is much better for the ICC to address these concerns at the Commission, rather than reopening Staggers and legislatively opening Pandora's box with unintended averse consequences from a restructuring of the basic legislation.

Thank you, sir.

Mr. Taylor. The only thing, if I might, Senator Pressler, add, is that there were a lot of financial studies and information put together as a kind of a predicate for the CURE legislation.

Director Young has put together a response—I think this is available and everybody has a copy of it—to those financial and cost predicates. It may even address some of the concerns Senator Rockefeller had. I don't know whether that is so specifically, but I would simply say that this is available and we would commend this to your attention, hopefully.

Senator Exon. Mr. Chairman, thank you for your patience. Just let me say we are not satisfied, gentlemen, and I will be glad to review what you have come up with here, but I think—don't leave here without the clear understanding that several members of this committee are not satisfied with what you have done to date. We may be wrong, but we are not satisfied. And we will press ahead on the CURE legislation.

Mr. Taylor. We got the message, and I will certainly take it back.

Senator Exon. Thank you, Mr. Chairman.

Senator Pressler. Senator Kasten.

Senator Kasten. No questions.

Senator Pressler. Senator Ford.

Senator Ford. I am just going to make one point, and then I may submit some questions in writing to the Chairman for the Commission.

But I want to substantiate Senator Rockefeller's concerns about the upcoming Commission. The Chairman will be leaving, and while I am not sure about Mr. Strenio's position, I do know about the Chairman.

Mr. Taylor. Well, his seat self-destructs, too.

Senator **Ford**. I understand that, but I am talking about positions on votes. I know that the Chairman dissented in the *Coal Export Exemption* case, and he was outvoted, but he was sustained by the courts. He dissented in the *Boxcar* case, and I believe he was vindicated in the courts. He dissented in the *Mid-Tech* case, and that is in the courts.

And so if you look at Mid-Tech as it relates to the relationship between shipper and carrier, it does give us some cause for concern, Mr. Chairman.

Mr. **Taylor**. Senator Pressler, I think it is terribly important, if I may, to add that just yesterday the Commission voted unanimously to request the court to remand *Mid-Tech* to us so that it can be considered in the light of the Ex parte No. 445 guidelines.

I had a lengthy dissent in that case, as Senator Ford has pointed out, but it is now back in front of the Commission to be considered in the light of what we did in both Ex parte Nos. 320 and 445. And I must say I am very pleased about that.

Senator **Pressler**. Senator Long.

Senator **Long**. Mr. Chairman, I have a commitment, and I think others have commitments between 12 and 2. I would hope very much that when we break from this session, we will break sometime after 12 o'clock and then come back around 2, so that Senators can fullfill their commitments.

Senator **Pressler**. Does that suit everybody? There is a vote on the Senate floor at this point, and I hope Senator Packwood is going to be back to chair.

Can I get the advice of my distinguished colleagues?

Senator **Ford**. That suits me fine.

Shall we break from 12 to 2? If we do that, basically we are breaking now.

The **Chairman**. Russell, let me ask you this. Have we finished with the ICC?

Senator **Pressler**. Yes.

The **Chairman**. OK. We have then still a number of witnesses to go. I don't see how we are going to finish the list today if we break now or at least it is going to be a long day. Are there any witnesses, if we went straight through, that we could take, do you think?

Senator **Long**. I would not object if you wanted to take the next three witnesses, Mr. Chairman.

The **Chairman**. Riley, Benson, and Fitzpatrick.

Senator **Long**. Yes.

The **Chairman**. Dempsey, too?

Senator **Long**. No objections from me, Mr. Chairman.

The **Chairman**. All right. Well, let's, Reese, let you and Andy go. Thank you very much.

Mr. **Taylor**. Delighted to have been here.

The **Chairman**. There is a vote now on the floor of the Senate, and I think one of us should be back at least to hear the testimony of the next four witnesses, and then the panel will be heard from at 2 o'clock, if that is all right with the panel.

Mr. **Taylor**. And if you want us to come back afterwards, later on, some other date, Senator Long, we will be happy to.

The CHAIRMAN. Let me ask the people on the panel, are they here now? Is there anyone who would be inconvenienced by proceeding at 2 o'clock?

[No response.]

The CHAIRMAN. All right. We would appreciate that if we could hear from you at two and in the meantime we will proceed with the other four.

Senator LONG. Lest I be misunderstood, Mr. Chairman, I think you are the best Commissioner on the Commission. I am sorry to see you departing. I think you have done your duty as the good Lord gives you light to see it, and that is all we can ask of anyone, even when we disagree.

Mr. TAYLOR. Thank you, Senator. I appreciate your kind words.

[The following information was subsequently received for the record:]

INTERSTATE COMMERCE COMMISSION,
OFFICE OF THE CHAIRMAN,
Washington, DC, December 19, 1985.

Hon. LARRY PRESSLER,
U.S. Senate, Washington, DC.

DEAR SENATOR PRESSLER: At the November 1, 1985 Oversight Hearing on the Staggers Rail Act of 1980, you requested an analysis of railroad grain contracts applicable for South Dakota shippers. You specifically asked for a breakdown, in number of contracts, between small and large shippers.

Our Office of Transportation Analysis reviewed 550 grain contracts applicable from, to, or at South Dakota stations. These contracts were filed over an 18-month period during 1984 and 1985 by the Burlington Northern, Soo Line, and Chicago and Northwestern railroads. Large shippers were identified primarily through use of the Grain 100 list, which consists of the top 100 grain companies in North America according to storage capacity. In addition, grain brokers were considered to be large shippers. Finally, based on staff's knowledge of the grain industry, supplemented by contacts with the United States Department of Agriculture, the remaining firms were categorized as either large or small shippers. Small shippers consisted primarily of country elevator firms.

During this period, the Burlington Northern filed numerous contracts which refunded rate penalities on overloaded cars. Accordingly, the contracts were separated into two groups—overload penalty refund contracts and rate contracts.

Overload penalty refund contracts, total reviewed 299; executed with small shippers 279; and executed with large shippers 20.

These contracts generally applied to most grain shippers on the BN system, that is, at all BN stations. Of the 279 contracts with small shippers, 18 were specifically with South Dakota country elevators.

Rate contracts, total reviewed 251; executed with small shippers 31; and executed with large shippers 220.

Generally, these were destination contracts applying from South Dakota (and other) stations, executed between grain firms not headquartered in South Dakota and railroads. Of the 31 contracts with small shippers, 20 were specifically with South Dakota firms.

If I can be of further help, please let me know.

Sincerely yours,

HEATHER J. GRADISON,
Chairman.

QUESTIONS OF SENATOR GORTON AND THE ANSWERS

Question 1. What is the Commission doing to resolve the ongoing controversy over the boxcar exemption proceeding as it relates to small railroads?

The Commission has before it a proposed settlement reached by the principal opponents, Conrail and the short line railroads. It has been over six months since this proposed settlement was filed. When will the Commission act on this settlement? Can you assure me that the Commission will address the proposed settlement in a timely fashion, once and for all?

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Answer. Because of the problems inherent in the original boxcar exemption, especially with respect to small railroads, the Commission, in Ex Parte No. 346 (Sub-No. 19), began a new proceeding which sought public comment on alternative approaches to improving the current car hire and car service regulations. Of the several proposals received in response to the notice, the one submitted by Conrail and the short line railroads appears to represent the most significant agreement among those parties who have been primarily concerned with the car hire/car service portion of the boxcar exemption.

On November 21, 1985, the Commission voted to issue a notice of proposed rulemaking which will suggest the adoption of this agreement, but which will also request comments on the proposal and on the others submitted. I have enclosed a copy of a press release reflecting the Commission's action. The decision itself will be published shortly in the Federal Register, and I will send you a copy as soon as it is served. Comments will be due 30 days after publication, and at that time, the Commission will be in a position to consider the comments and to make a final decision.

Question 2. Short line railroads appear to be viewed by the Commission as being capable of competing on an equal footing with the large Class I rail systems. Is this correct?

Answer. As noted in my separate expressions to the prior boxcar exemption decisions, the car hire and car service regulations imposed by such decisions would have seriously jeopardized the economic survival of the Nation's Class III carriers.

Fortunately, the Commission is now embarked upon a course that should have been followed from the outset. The joint rate issue, which is being considered in Ex Parte No. 346 (Sub-No. 8), and the car hire matters under consideration in the Sub-No. 19 proceeding, are moving forward on separate tracks. More importantly, in both proceedings, appropriate consideration is now being given to the concerns of short line railroads. Indeed, in the car hire proceeding, the Commission has proposed to adopt as rules the agreement that was filed by Conrail and a number of the short line railroads.

Hopefully, the Commission will reach a timely resolution of the proceeding in Ex Parte No. 346 (Sub-No. 19). However, since action on this rulemaking will not be ripe until next year, and since I will be leaving the Commission at the end of this year, I cannot give you any positive assurances as to when or how the Commission will finally act.

Question 3. Is it correct that the Commission has now undertaken a new proceeding to review car hire regulation of all railcar types other than boxcars? Do you plan to complete the boxcar proceeding, which I understand has been going on now for about four years, before you begin addressing other railcar types?

Answer. Yes, in Ex Parte No. 334 (Sub-No. 6), served April 29, 1985, the Commission has instituted a proceeding to determine whether the regulation of car-hire charges (except boxcars) should be retained, modified, or eliminated. In the advance notice of proposed rulemaking that was issued, the Commission sought comments on how the present system of car hire compensation could be improved, either by modification to reflect more market-oriented approaches, or by substantial elimination of the system through various degrees of deprescription. The record in this proceeding closes on January 8, 1986, and thereafter, the Commission will be able to consider the comments and take action.

Once again, since I will be leaving the Commission at the end of this year, and since both the Sub-No. 6 and Sub-No. 19 proceedings will not be ripe for action until next year, I cannot predict with certainty what the Commission will do with respect to either of these proceedings.

QUESTIONS OF SENATOR LONG AND THE ANSWERS

Question 1. Please provide a list of all decisions by the Commission since the passage of the Staggers Act granting relief to a captive shipper. For each such decision, please provide:

a. The title.

b. The docket number.

c. The decision maker (i.e., Administrative Law Judge, Commission, etc.) and the date of decision.

d. The rate or practice being challenged.

e. If a rate reasonableness case, the revenue to variable cost ratio of the challenged rate.

f. A brief recitation of the facts of the case.

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g. The subsequent history of the case after the captive shipper's victory, including current status.

h. Whether the decision was based upon pre- or post-Staggers Act principles, and whether it will now be reconsidered under post-Staggers Act principles.

i. The extent of rate relief granted to the Shipper.

j. The amount of reparations awarded and actually paid.

Answer. The attached lists[1] provide the information requested. As requested, we have included any decisions, regardless of the decisionmaker. To the extent parties have not settled their disputes, all reasonableness cases involving captive shippers remain open, to be decided expeditiously under the final Ex Parte No. 347 (Sub-No. 1) guidelines. Also see response to Question 2.

Question 2. Based upon your answer to question 1, please list separately the cases in which a captive shipper has won a final decision from the Commission granting relief from an unreasonably high railroad rate under Staggers Act principles.

CASES WHERE A CAPTIVE SHIPPER HAS WON A FINAL DECISION GRANTING RELIEF FROM AN UNREASONABLY HIGH RATE UNDER STAGGERS ACT

(Cases discussed in body of response 1)

Answer 1. No. 37338—Complaint withdrawn; case dismissed 6/22/83.

2. No. 37450—Dismissed at request of parties 8/24/83.

3. No. 37516—Complaint withdrawn by parties 2/22/84.

4. No. 37615—Proceeding reopened and complaint dismissed with prejudice at request of complainant 7/21/83.

5. No. 38186, 38184, and 38185—Complaints dismissed 7/12/85 at request of complainants; settlement contracts negotiated.

Congress gave the Commission a very difficult and delicate task to perform when it enacted the Staggers Rail Act of 1980. In recognition of the dire financial condition of the rail industry, Congress directed the ICC to allow rail carriers to earn adequate revenues. The Staggers Act also authorized greater flexibility in ratemaking and, for the first time, specifically permitted private contracting for rail service. However, because some of the railroads' customers may be captive, the Commission was directed to ensure reasonable rates where the carriers had excessive market power.

Consistent with the new policies, the Commission has developed guidelines to determine whether the prices that railroads charge their captive customers who ship coal are too high. Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines, Nationwide,* I.C.C. 2d (served September 3, 1985), was the culmination of many years of effort by the Commission and all concerned parties to implement the competing goals of the Staggers Act. During consideration of this proceeding, the pending cases were held in abeyance to minimize unnecessary cost to the parties and the government. Guidelines for non-coal cases have not yet been established.

After the guidelines were issued, the Commission immediately asked the participants in the few remaining cases (34) to express their views on how the cases should proceed in view of the new guidelines. The answers that were received indicated that some cases had been or would be settled, that some cases needed more evidence, and that some were now ripe for decision. The Commission is now proceeding to handle and decide these cases under the new guidelines.

Question 3. Please comment on something that Alfred Kahn said in December of last year. In a speech to the Annual Meeting of the American Economic Association and Society of Government Economists, he said that "[m]any railroads are evidently earning the cost of capital on their incremental investments, and are therefore able to attract the additional capital they require." Now, as you know, Dr. Kahn is no friend of regulation. What do you think of his revenue adequacy test, that is, cost of capital on incremental investments?

Answer. Revenue adequacy is meant by statute to be a test of a railroad's ability to attract the capital necessary for continuation of efficient services. Capital is thus required not only for new undertakings, but for the replacement of existing tracks and equipment on lines that have the potential for continued economic vaibility. Since passage of the Staggers Act there has been an increased willingness on the part of managers and investors to commit capital to these undertakings, and this willingness is in part due to a belief that the regulatory atmosphere will not impede an adequate return to investments that are otherwise well-attuned to market demand. Indeed, the elimination of a "regulatory risk" factor probably works to lower the price of capital that is available.

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[1] The attached lists were retained in the Committee files.

From the fact of vigorous new investment, it is fair to infer that rail managers and their capital suppliers believe that there will be sufficient income to cover the capital costs thus incurred, if not immediately, at least at some future point. In this sense, we would agree with Dr. Kahn that the railroads are evidently earning (or, at least hold the belief that they will earn) the cost of capital on their new incremental investments. We would add the caution that any too abrupt change in regulatory climate could evaporate that belief, and make future investment more problematical.

Because the quotation from Dr. Kahn is sketchy, it is difficult to comment much further. In testimony presented to the Commission on similar issues, Dr. Kahn has argued that a full economic return on assets that are no longer productive (used and useful, in the terminology of regulation) is unnecessary. If it is in the sense that Dr. Kahn distinguishes the incremental future investment from past investment decisions which will not be replicated, we are in full agreement. Indeed, the Commission initially considered a proceeding to identify unproductive assets and segregate them from its return calculations. As it has turned out, such an undertaking looks to be unnecessary since the marketplace, functioning with the improved freedoms of the 4R Act, the Staggers Act, and the Northeast Rail Services Act, is doing the job more rapidly and accurately than we might have hoped. Since 1975, the net investment of all Class I railroads in physical property has declined by nearly one-third, expressed in constant dollars. The railroads are continuing to identify and eliminate unprofitable operations, and the discrepancy between an efficiently-sized system and the system in place is dissolving rapidly. Nevertheless, the Commission does not disagree with the principle that a full return on redundant or obsolete investment is not properly a part of its revenue adequacy goals.

Question 4. Your March 1981 revenue adequacy decision in Ex Parte No. 393, which adopted your current test, acknowledged that based on the new standards, "only a small number of railroads will be found to have adequate revenues." The decision then goes on to say that that should not be surprising, since Congress found in the Staggers Act that the railroads would suffer a $16 to $20 billion capital shortfall by 1985. It's now 1985. Is there a capital shortfall? Haven't the railroads been able to make their capital improvements, the ones they tout so much in their advertising and their statements to this Congress, out of internally generated funds? Doesn't that suggest to you that perhaps the time has come to change the Commission's revenue adequacy test in light of changing conditions?

Answer. The railroads' capital shortfall of $16 to $20 billion between 1975 and 1985 was projected by a special study conducted by the United States Department of Transportation, pursuant to the 4-R Act of 1976. Subsequent efforts to overcome the capital shortfall have been aided by favorable changes in the overall economic and regulatory environment of the railroads, including massive restructuring within the industry, easing of regulatory constraints, and direct financial assistance from the Federal government. The extent of any remaining capital shortfall cannot be calculated, absent further special studies, but it is fair to say that the railroad system no longer shows signs of continuing deterioration and collapse.

The Commission believes that improvement in railroad capital structure can be directly related to beneficial changes in regulatory climate, effectuated through the Staggers Act. Continued financial stability requires a regulatory climate in which the prospect for adequate return to investment is not foreclosed. Willingness to renew investments, whether the funds are internally or externally generated, is dependent upon a comparison of opportunities inside and outside of the railroad sector. Consequently, any too abrupt change in the concept of revenue adequacy would negatively affect the transport system.

It is important to keep in mind that the concept of revenue adequacy is primarily a goal, meant to reorient federal rail policy back towards market realities. By and large, decisions in particular adjudications are made according to more specific standards, where the goal of revenue adequacy will not be the sole criterion. In the area of maximum rates, speaking particularly of coal rates, the Commission's policies balance the need for revenue adequacy against very real constraints designed to protect captive shippers from a disproportionate burden, and from any burden whatsoever that might be imposed by inefficient practices or investments. The Commission's revenue adequacy standards will certainly evolve as experience dictates and we are reviewing public comments on proposals to fine tune those standards.

Question 5. Regarding the *Midtec Paper Corporation* v. *Chicago & Northwestern* case, how does reconsideration solve the problem? Wasn't the issue in *Midtec* the Congressional intent in what a shipper had to show in order to obtain a competitive access remedy? Why would Congressional intent change from July, when you issued the decision, to today, when reconsideration is underway? And didn't *Midtec* overrule a 1983 decision, the *Delaware & Hudson* v. *Conrail* case, So will reconsideration accomplish another sudden change? What about the poor Midtec Paper Company, which is the victim of all this indecisiveness—doesn't it have a valid complaint about the fairness of the process at the ICC?

Answer. In *Midtec Paper Corporation, et al.* v. *Chicago & North Western Transportation Company (Use of Terminal Facilities and Reciprocal Switching Agreement)*, 1 I.C.C. 2d (1985), a majority of the Commission[2] found, based on the evidence of record, that: (1) reciprocal switching was not shown to be (a) in the public interest, and (b) necessary to provide competitive rail service; and (2) use of terminal facilities was not shown to be in the public interest. The majority based its public interest determination both for use of terminal facilities and for reciprocal switching on established case law. That is, the public interest showing requires proof of actual necessity or compelling reason for the service. More than a mere desire on the part of shippers or other interested parties for something that would be convenient or desirable for them must be shown.

In reaching its decision, the majority followed the basic public interest standard used in *Delaware & H. Ry. Co.* v. *Consolidated Rail Corp.*, 367 I.C.C. 717, 720-21 (1983). *Midtec* did not overrule the entire *Delaware & Hudson case*, but did reverse on the issue of whether intermodal competition may be considered in a reciprocal switching case.

In its efforts to fulfill statutory intent, the Commission has from time to time reevaluated its views on many issues. The area of competitive access is no exception to this ongoing process. In Ex Parte No. 445 (Sub-No. 1), *Intramodal Rail Competition*, the Commission had the valuable opportunity to reflect on several competitive access issues, including reciprocal switching. The Commission was aided in its consideration of these issues by the comments of numerous concerned parties representing the shipping public, the general public, and the railroads. With the benefit of these comments, both incisive and comprehensive, the Commission has developed rules to govern its consideration of several important competitive access areas. As a result, the Commission will now evaluate requests for reciprocal switching under more comprehensive criteria than were available in deciding either *Delaware & H.* or *Midtec*.

As the Commission will be using the Ex Parte No. 445 (Sub-No. 1) criteria to judge all future requests for reciprocal switching, we consider it only reasonable and fair to reopen *Midtec*. Our decision to reconsider what was for the Midtec Paper Corporation an adverse decision, can only be viewed by that company as a positive first step.

Commissioner Simmons, separate response:

In the *Midtec* decision, I would have authorized reciprocal switching or use of terminal facilities. My reasons are set out in my separate expression to that decision. It is my hope that reconsideration of *Midtec* under the standards adopted in Ex Parte No. 445 (Sub-No. 1) will result in a more focused analysis of all the issues presented there.

Question 6. Please address what may be a fundamental contradiction in how the Commission is implementing the Staggers' Rail Act. On the one hand, there is a revenue adequacy test, which says that no matter what the stock market, or Moody's or Standard & Poor's may say, every major railroad in the United States is revenue inadequate and will continue to be so, at least for the near term. The Commission says that competitive traffic can't carry the burden of getting the railroads to revenue adequacy, because railroads must meet truck or barge competition. So captive shippers have to shoulder the revenue adequacy burden. There are numerous captive shipper cases pending before the Commission in which shippers say or Administrative Law Judges have found that the railroads are charging twice, three times, in some cases ten or twelve times the variable costs of moving the captive traffic. Now how are we in Congress to reasonably believe that captive shippers will get any real rate relief from a Commission that insists the railroads need even more money, and must get it from captive shippers?

Answer. We see no contradiction in terms of the way the Commission is implementing the Staggers Rail Act (Act). The Act placed special emphasis on the concept of rail revenue adequacy. Section 201(a) of the Act requires the Commission, in determining whether a rate is reasonable, to recognize the policy that rail carriers

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[2] Former Chairman Taylor and Commissioner Simmons dissented. Commissioner Simmons' position is stated separately below. Commissioner Lamboley would have withheld action pending the outcome of Ex Parte No. 445 (Sub-No. 1) and took no position on the merits.

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shall earn adequate revenues. The Commission, however, is also statutorily required to ensure that rail rates are just and reasonable. We believe that the guidelines recently promulgated in Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines, Nationwide*, provide the framework for ensuring that our statutory obligations are carried out.[3]

From the carrier's perspective, the coal rate guidelines provide efficient carriers with the opportunity to engage in differential pricing so that they can cover all their costs and earn a competitive rate of return, i.e., become revenue adequate. Captive shippers, on the other hand, are protected from paying rates which yield monopoly profits or which otherwise underwrite inefficient operations, investments or pricing practices. Under the "constrained market pricing" approach developed in Ex Parte No. 347 (Sub-No. 1), rail carriers' pricing of market dominant coal traffic is subject to four constraints. First, a coal shipper cannot be charged more than the "stand-alone cost" of servicing its traffic. Second, captive shippers will not be required to bear the cost of obvious management inefficiencies. Third, carriers will not be permitted to increase their rates on captive coal traffic in a manner which would be economically disruptive. Fourth, until a rail carrier achieves revenue adequacy, it is free to adjust its rates unless it violates one of the three constraints previously listed.

Stand-alone cost (SAC) theoretically is the least costly alternative service a hypothetical competitor could offer for the transportation of captive traffic. It represents the current resource cost an efficient competitor to the existing railroad would incur. SAC introduces a surrogate for competition into a market where competition is absent.

The concept of management efficiency ensures captive shippers that they need not pay more for service than absolutely necessary.

Under the management efficiency constraint, shippers can offer evidence that a carrier's projected revenue need shortfall is overstated due to operating, pricing or investment inefficiencies. If the quantification of these overstatements is valid, the carrier's revenue need shortfall will be reduced commensurately. Thus, this constraint provides a valuable tool which can be used to refute a railroad's claim of revenue inadequacy.

Prior to their final adoption by the Commission, the coal rate guidelines were used on an interim basis to test their practicality. In this regard, the Department of Energy (DOE), in an independent evaluation of the Commission's policy with respect to coal shippers, concurred that constrained market pricing is a reasonable approach to regulating captive coal rates.[4]

Over the past decade, rates for the transportation of coal, as well as rates in general, have increased rapidly. The increase in coal rates is due to several factors, not the least of which is the impact of double-digit inflation on the railroads. When adjusted for inflation, however, rate levels for coal showed no increase between 1973 and 1983. With regard to rate reasonableness, one of the central findings of the DOE study is that the railroads have not abused their market power over captive shippers.

In conclusion, the Commission's implementation of the Act has served to balance both the needs of the railroads (financial viability) and the needs of captive shippers (protection from market abuse).

Question 7. The ICC is required by law to calculate an annual revenue to variable cost ratio for recyclable commodities. Is this ratio set so that if the railroads charged all their traffic at this ratio, they would recover all variable costs, fixed costs and a reasonable profit?

Answer. The ratio for recyclables is set as a figure that represents the average ratio that would be required of all rates, if adequate expenses and profit are to be recovered. However, if this ratio were to be charged all traffic, much of the traffic base would disappear, as competitive alternatives exist for many commodities. Such a reaction would drive the ratio continually higher, extracting a growing proportion of revenue requirements from captive traffic.

Question 8. What has been the ICC's recyclable revenue to variable cost ratio in recent years?

Answer. The revenue to variable cost ratios are as follows:

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[3] The guidelines apply only to captive coal traffic. The Commission has stated that it would seek public comment on the appropriateness of applying the guidelines to non-coal captive traffic.

[4] See staff working draft on "Effects of Railroad Regulatory Reform on Coal and Electricity," May 1985.

	Percent
1981	146.0
1982	143.8
1983	152.2
1984	158.6
1985	153.4

The ratio developed for the year 1986 is 152.5%. The 1986 ratio is pending Commission approval.

Question 9. Is it accurate to say that the revenue to variable cost ratio for recyclables is a fair surrogate for a ratio that would cover all railroad costs, including a fair profit?

Answer. Yes (see response to Question Number 7). However, it must be noted that for a railroad to cover all of its costs and earn a profit, either its rates must average this ratio or each rate must be set at this level. As indicated in our response to question 10, railroads must have broad flexibility in setting rates if they are to maximize the net contribution of each movement to total costs and profit. If rates for highly competitive traffic are set too high, the traffic will be lost to other carriers or modes. Similarly, if less competitive traffic is not differentially priced along the lines established by Long-Cannon and the Commission's maximum rate guidelines, earnings will be lost. Thus, adequate returns for the rail system require a rate structure that contains rates that lie both above and below the recyclable return ratio.

Question 10. The current market dominance test, as implemented by the Commission, states that a shipper must first demonstrate that his revenue to variable cost ratio is at least 180 percent. Doesn't the Staggers Rail Act give the railroads the absolute freedom to differentially price captive traffic at least to the extent of that difference between the recyclables ratio and the 180 percent?

Answer. The Interstate Commerce Act, as modified by the 4R and Staggers Acts, limits the Commission's jurisdiction by means of a number of cost tests and qualitative tests of competition. With regard to minimum rates, the Act requires that a rate contribute to the going concern value of the railroad. In Ex Parte No. 355, *Cost Standards for Railroads*, the Commission established Directly Variable Costs (DVC) as a presumptive cost floor. Rates above this level are presumed not to be unreasonably low.

The Staggers Act established a jurisdictional threshold for rates to provide upside rate flexibility. This threshold is the calculated Cost Recovery Percentage, provided it falls within a range of 170 percent of variable costs to 180 percent of variable costs. If the calculated Cost Recovery Percentage is above 180 percent the threshold is set at 180 percent. If it is below 170 percent the threshold is set at 170 percent. As long as a rate exceeds going concern value and is less than the jurisdictional threshold, the Commission has no authority to question the reasonableness of the rate. Thus, railroads can differently price within this range without Commission interference.

This range of differential pricing however, may be insufficient to permit a carrier to cover all of its costs. Therefore, carriers can differentially price above the jurisdictional threshold. If traffic is not captive, the limit to differential pricing is set by the market. The level of differential pricing for captive traffic is limited by the Commission's maximum rate policy. Under this policy, differential pricing is limited to that necessary to cover economic costs and earn a normal profit overall.

Question 11. Are you aware of any legislation pending before this Congress that would change that 180 percent figure or the way in which it is calculated?

Answer. While we are unaware of any pending legislation to amend the 180 percent figure or its calculation, a number of bills propose equally dramatic changes to our jurisdictional analysis. S. 477 contains such changes affecting our jurisdiction. Section 3 of that bill includes the guidelines adopted by the Commission in Ex Parte No. 320 (Sub-No. 3), *Product and Geographic Competition*, I.C.C. 2d (served October 31, 1985). However, the last sentence of section 3 is in addition to the Commission's guidelines, and is a proposal that the Commission specifically rejected because alternative destinations may effectively restrain railroad pricing and because the railroads have the burden of showing that origin, geographic, and product competition, in actuality, constrain their pricing. S. 201 and H.R. 540 contain other significant changes to expand our rate reasonablenees jurisdiction.

Question 12. During your tenure on the Commission, has the Commission ever rejected an application for approval of a railroad merger or acquisition?

Answer. In Finance Docket No. 28640 (Sub-No. 9), et al., the Commission considered several proposals for the acquisition and reorganization of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. The proposals submitted by the

Grand Trunk Corporation and the Chicago Milwaukee Corporation were denied as being contrary to the public interest. The proposals submitted by the Soo Line Railroad Company and the Chicago and North Western Transportation Company were found to be in the public interest, but Soo's proposal was determined to be preferable. See *Milwaukee—Reorganization—Acquisition by Grand Trunk Corporation*, I.C.C. 2d (served September 26, 1984) as supplemented I.C.C. 2d (served January 11, 1985).

Otherwise, I am not aware of any railroad merger or acquisition application that was denied by the Commission during my tenure at the I.C.C.

Question 13. Your prepared statement at page 25 says that the Rail Cost Adjustment Factor set forth in Section 203 of the Staggers Rail Act is designed "to allow carriers to offset inflation by raising their rates without challenge." Captive shippers complain that the way the Commission has implemented this inflation factor gives the railroads a windfall. First, the factor does not properly account for railroad productivity increases. Second, when the factor goes down the rates don't go down. Now if all Congress intended was to allow carriers to recover their inflation-based cost increases, why shouldn't the factor accurately measure inflation? Why should shippers pay for phantom inflation? In a competitive environment, aren't most productivity improvements passed on to the customer?

Answer. The Rail Cost Adjustment Factor (RCAF) is calculated from an index of railroad input costs which measures changes in the railroad industry's cost of doing business. The current all inclusive indexing methodology, which has been used for almost a year, was developed through an extensive rulemaking proceeding which considered the suggestions of individual shippers, shipper associations, state and federal government agencies, and the railroad industry. The current methodology uses more railroad specific factors for the measurement of index components than the interim methodology which relied on Producer Price Index factors. Railroad specific factors are preferable to indicators of the general economy such as the Producer Price Index. We believe that the current methodology accurately measures inflation in the railroad industry and is a substantial improvement over the interim methodology.

The measurement of railroad productivity changes is currently being considered in Ex Parte No. 290 (Sub-No. 4), *Railroad Cost Recovery Procedures—Productivity Adjustment*. Evidence submitted in this proceeding is being analysed by Commission staff. Although productivity measurement is the subject of a separate proceeding, productivity changes are also reflected in the current indexing methodology because of the annual reweighting of the various index components and the adjustment of the index for union contract provisions which affect the hourly wage of railroad employees. The annual reweighting of index components is based on each component's relative percentage of total railway expenses. Productivity improvements which result in a given component of dollar savings reduce the relative importance of that component as a part of the total index. Certain provisions in the current United Transportation Union contract which result in increased productivity are recognized. For example, the gradual elimination of certain arbitrary payments was considered in determining the wage levels used in the first quarter. This recognition of productivity in the development of the factor passes benefits to the customer as would occur in a competitive environment.

With regard to rate reductions, the RCAF does not directly provide for rate decreases when the factor declines. There is no practical way of implementing such reductions directly. In addition, the Commission has no authority to require rate reductions for competitive traffic or for traffic with rates below the jurisdictional threshold. Traffic within the Commission's jurisdiction would have to be identified on a case-by-case basis. Even then, there remains a question of whether an otherwise reasonable rate should be reduced because of a decline in the RCAF. However, the RCAF takes cost factor declines into account in subsequent quarterly RCAF computations. Therefore, while decreases in rates cannot be made directly, these decreased factors are indirectly taken into account in all future RCAF calculations.

Question 14. Mr. Chairman, you have in some of the most important Commission decisions, some of the decisions that shippers complain about the most, been in the minority. You dissented in the Coal Export Exemption case. What was the basis for your dissent? You were upheld in the courts on that, weren't you? Do you stand by those views today?

Answer. My dissent in the coal export exemption case was based on my analysis of the legislative history of the Staggers Act, which reflected a particular congressional concern over captive coal traffic. Despite evidence of record that 95% of the mines producing export coal were captive to just one railroad, and that the exemption would lead to increased rates and decreased demand, the majority found, based primarily on a summarization of the proponent railroads' comments, that reliance on the world market and on the leverage of a few large shippers would constrain prices.

The courts upheld my position because, in the words of the U.S. Court of Appeals for the District of Columbia, the majority's decision bore "the earmarks of a hasty rout, not the measured passage from the old regime to the new for which Congress provided."

I continue to stand by the views expressed in my dissents in this proceeding, and, barring a change in the evidence, which is now several years old, would vote the same today.

Question 15. You also dissented in the *Midtec* case. What was the basis for your dissent there? Do you think that the Commission or courts will ultimately adopt your views?

Answer. The basis of my dissent in the *Midtec* case was threefold. First, in my view, complainants satisfied the statutory standards of Section 11103(a) and Section 11103(c), which govern requests for the joint use of terminal facilities and reciprocal switching relief. Under these circumstances, I felt that granting relief under both of these Sections was warranted.

Second, it was my view that granting such relief would also be consistent with the Congressional goals underlying the procompetitive provisions of the Staggers Act. It was through these provisions that Congress intended to promote rail-to-rail competition as a competitive counterbalance for shippers vis-a-vis the increased rate freedom that the rail carriers were provided in other provisions of the Staggers Act.

Third, in denying the relief sought in the *Midtec* case, a majority of the Commission applied a new and substantially more onerous standard for deciding requests for reciprocal switching and the joint use of terminal facilities. In my view, the standard that was applied is contrary to the statute and totally inconsistent with Congressional intent.

The standards that were applied in *Midtec* were subsequently superseded by the new rules the Commission adopted in Ex Parte No. 445 (Sub-No. 1), *Intramodal Rail Competition*. Also, the Commission has requested the U.S. Court of Appeals for the D.C. Circuit to remand the *Midtec* case for reconsideration in light of our decision in Ex Parte No. 445 (Sub-No. 1). Therefore, assuming the Court acquiesces in the Commission's request for a voluntary remand, the *Midtec* case will ultimately be decided under the new standards adopted in Ex Parte No. 445 (Sub-No. 1).

Question 16. You also dissented in the boxcar exemption case. What was the basis for that dissent? Weren't you upheld in the courts on that, too?

Answer. Yes, I also dissented in the boxcar exemption case, and subsequently except for that part of the exemption pertaining to single-line boxcar rates, the majority's decision was overturned by the courts, and the matter was remanded to the Commission.

My dissent was based on my analysis of the Commission's responsibility, as mandated by Congress, to rationally deregulate the railroad industry in a manner consistent with the National Transportation Policy. This policy emphasizes the necessity of preserving competition and protecting shippers against the abuses of market power.

The exemption was opposed by virtually every group that participates in or depends upon our national railway systems, and the evidence of record overwhelmingly failed to support any of the necessary findings required by the exemption provisions of the statute. In fact, the evidence clearly showed the adverse impacts that immediate implementation of the approval would have had, particularly upon the nation's Class III railroads.

Question 17. Is there a common thread to your dissents? What kind of decision-making philosophy have you tried to follow so that you ended up in the minority on these and other issues, and why is that philosophy at odds with the majority?

Answer. The common thread running through all the votes I have cast during my tenure at the Commission has been a sincere effort to implement the will of Congress by following the laws under which our decisions are made.

In the Staggers Act, Congress sought to achieve a carefully crafted balancing of competing and, at times, conflicting interests. The railroads were provided substantially more rate and service freedoms. However, to counterbalance these new freedoms, Congress maintained a regime of rate regulation for captive shippers, and in addition, such shippers were afforded protections under the procompetitive access provisions of the Act.

Throughout my tenure at the Commission, I have attempted to promote these competing Congressional goals by reducing regulation of the rail industry whenever warranted, so that rail carriers have an opportunity to earn adequate revenues,

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while also making sure that shippers without competitive alternatives have reasonable and adequate redress in the event they are subjected to anticompetitive conduct.

Only my colleagues can answer the question of why their views were sometimes at odds with mine.

Question 18. Your dissent in the *Midtec* case says that Congress intended in the Staggers Act to strike a balance between the needs of the railroads and the needs of their shippers. Part of the bargain, you seem to say, was that in exchange for a substantial amount of rate freedom for the railroads, Congress intended to provide opportunities to enhance railroad-to-railroad competition to the benefit of shippers. Is it your view that the Commission is not fulfilling the second part of that Congressional bargain?

Answer. Undoubtedly, some of the Commission's past decisions involving "competitive access" issues have been unpopular with certain groups and have sparked calls for re-regulation of the railroad industry. However, the Commission has recently taken a number of steps which address these concerns.

Most importantly, in Ex Parte No. 445 (Sub-No. 1), *Intramodal Rail Competition*, the Commission adopted, with some minor modifications, the competitive access agreements that were reached by the American Association of Railroads with the National Industrial Transportation League and the Chemical Manufacturers Association. The new rules, which resulted from extensive negotiations between the railroads and a broad segment of the shipping community, will govern the Commission's handling of the cancellation of through routes and joint rates, and the prescription of through routes, joint rates, and reciprocal switching.

In my view, these new rules, if properly applied in individual cases, will promote competitive rail access and achieve the balance sought by Congress in the Staggers Act.

Question 19. How can the Commission improve its obligation and to fulfill the second part of the bargain?

Answer. The Commission can meet its Congressionally mandated obligation by simply following the provisions of the Staggers Act and by increasing the agency's commitment to striking a fair and reasonable balance between carrier and shipper interests.

Question 20. The response of any other Commissioners to questions 18 and 19 would be welcome.

Answer. Through its competitive access rules in Ex Parte No. 445 (Sub-No. 1), *Intramodal Rail Competition*, adopted subsequent to *Midtec*, the Commission is providing opportunities to enhance necessary railroad-to-railroad competition in a manner that reflects the intent of the Staggers Act and ultimately benefits shippers. These rules reflect, to a large degree, a consensus view arrived at by railroads and shippers in a series of conferences stemming from the Commission's comprehensive review of the Staggers Act in Ex Parte No. 456

Application of the Commission's new competitive access rules will provide greater railroad-to-railroad competition in those circumstances where it is necessary.

Senator **Pressler**. Could we ask people to remain in their seats and not go out, because it takes about 5 minutes when we come back to settle everything down. Why doesn't everybody who is here just stay in their seats while we go vote?

[Recess.]

The **Chairman** [presiding]. I guess everyone chairing a meeting operates differently from everyone else. Some people have no limits on questioning time or testimony time. Some people have 10-minute limits. I am a 5-minute limit person.

Your prepared statements will be included in the record in full. You don't even have to ask permission that they be so included. They will be included in full as a matter of course. If you could keep your testimony to 5 minutes and then if Senators' questions could be limited to 5 minutes, I would appreciate it. Otherwise, I don't see how we are going to get through this list until some time this evening.

John Riley, thank you very much.

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STATEMENT OF HON. JOHN H. RILEY, ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION

Mr. RILEY. I will do my best, Senator.

Senator, it was about 6 years ago that one of my predecessors, Jack Sullivan—who was the fifth Federal Railroad Administrator—came before this committee to testify on exactly the same subject we are meeting on today.

Jack was a Democrat and I am a Republican, and we represent two very different administrations. But we came from basically the same direction on this issue, and because the committee shared that view and because of the leadership I see Senator Cannon provided, among others, the railroad environment is very different today than it was 5 years ago.

As the committee looks in oversight at Staggers, I think it is important to take where we were 5 years ago as a benchmark and look at where we are today in comparison, across the board, for railroads and shippers alike.

When Congress debated the Staggers Act, nearly one-quarter of the Nation's track was in bankruptcy. The prosperous 1970's had seen the bankruptcy of 10 major rail carriers, and a complete collapse of two regional rail systems; 4,300 miles of track were under slow order at the time, which was a problem for shippers in service and a problem for us at FRA in safety. Even the strongest railroads had a very tenuous hold on stability, with an ROI or "Return on Investment," that hovered around 1 percent.

The industry was truly on its knees and nationalization was a frankly and honestly discussed alternative. And I brought with me an old cartoon from those days to share with the committee this morning, and I think it says in a picture—it will probably take 3 minutes out of my testimony by showing you that picture.

What I want to emphasize, Senator, is that there were no winners under the old regulatory system because the problems that touched the railroad touched every shipper, every community, and virtually every employee. No one was hit harder than the rural shipper, as railroads siphoned cash out of the lighter density lines to focus what they had on the heaviest density main lines. Poor cash flows meant car shortages, derailments, unreliable service, and a new accident incident entry for us, the standing derailment. That occurred when a railcar standing perfectly still simply fell off the tracks. And that happened twice in 1 year.

We have come a long way since then, a long way. And the committee made it possible.

The contrast between then and now is really the best testimony to the success of Staggers. The industry survived the deepest recession since the 1930's without a single bankruptcy. Capital investment has increased every year, including the deep recession year of 1982. I cannot tell the committee that the $13 billion capital gap Reese Taylor referred to has been completely closed, but deferred maintenance has been virtually eliminated from the Nation's main lines, and the pace of abandonments has slowed by about a quarter since the Staggers Act was passed.

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I want to associate myself with Senator Pressler's comments on light density lines. I agree very much with his philosophy and where he is coming from on that.

The boxcar shortage evaporated when shipper contracts enabled carriers to plan the utilization of their equipment, and the number of covered hopper cars is at an all-time high. The industry's return on investment has increased fivefold, to the lofty figure of 5.7 percent, and that is a revealing figure because it tells both sides of the story. That is a dramatic increase from the 1- to 2-percent levels of the last two decades, or the two decades before Staggers. But it is less return than an investor could get by simply putting his money in a passbook savings account.

As the Nation's utilities have argued so persuasively and correctly in their own rate cases, an industry that cannot generate a return on capital equal to the cost of borrowing is an endangered species. And these ROI figures emphasize the extent and at the same time the fragility of the industry's recovery. The progress is real, but it can be easily eroded.

In assessing the impact of these accomplishments on national policy, there are two points that I would summarize that are detailed at length in my testimony for the committee to consider. One is that no one has gained more from this than shippers have.

It was just a few years ago that railroad marketing was virtually a contradiction in terms. Today railroad marketing means multiple car rates, lower rate backhauls, just-in-time service, an array of benefits for shippers that would have been impossible under a system that required the carriers to repeatedly go back to the Commission with delays for flexibility.

In addition to becoming more price competitive, the railroads have become more reliable in their service, and shippers have shared, like everyone else has shared, in the public benefits of Staggers.

My agency in 1978 spent $1.99 billion on freight assistance. Last year, we spent about $40 million in freight assistance, and that real meaningful budget reduction is directly attributable to Staggers.

With stronger capital investment levels on the railroads, there has been a historic improvement in railroad safety. The number of accidents in 1979, the year we passed this act, was three times the number of accidents on the railroads today.

But simple statistics make it indisputably clear that the railroads' improved financial condition has not come at shippers' expense. Across the board, in every category, rail rates have risen at about half the level that they rose prior to the passage of the Staggers Act.

And I will conclude with two comments to keep myself near your 5-minute limit. During the 5 years preceding the passage of the Staggers Act, rail rates rose an average of 10.6 percent annually. In the 5 years after Staggers, they have risen at 4.6 percent and are down to less than a half a percent over the last 12 months, a clear indication that railroads have not abused their pricing flexibilities.

In the coal field in particular, railroads' coal revenue per-ton-mile has actually decreased over the past 3 years, and in constant dollars, rail rates for coal today are lower than they were in 1972.

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Mr. Chairman, I do not want to be misinterpreted as coming before this committee and saying that the transition to Staggers was a painless one. It was not a painless transition. The act changed patterns of shipping that existed in this country for half a century. There were pains of transition. There were hard cases, and will always be, that must be addressed on a case-by-case basis. And the existence of the captive shipper is a reality; it is not a myth.

But the theme that should come clearly through from this oversight hearing is that the railroad industry has not abused its pricing and marketing opportunities, and because of those opportunities has become more stable while providing better service. And it should also be clear that while no system dependent on human judgments will ever be flawless, allowing the commercial relationship between shippers and carriers to be shaped by market forces has produced better results for both than a system which delegated those decisions to a board of political appointees.

I have said more things, Mr. Chairman. I will leave those in my testimony for the committee to examine.

The CHAIRMAN. I appreciate the conciseness and speed of your presentation.

Mr. RILEY. Well, I can attest to the speed. I am not sure about conciseness, but I appreciate the chairman's comments.

The CHAIRMAN. Senator Pressler.

Senator PRESSLER. Thank you, Mr. Chairman.

I note that all our colleagues who asked for more witnesses have disappeared.

We welcome you here, and let me say that I have enjoyed working with you on a number of these issues. Let me ask you some questions regarding smaller populated States, such as South Dakota.

Can you discuss the activities of the Community Shipper Assistance Staff Strike Force?

Mr. RILEY. I can, Senator. And it gets back to—in my opening statement I associated myself very strongly with the comments that you had made on light density lines. I think your comments were correct and perceptive and very much reflect my own philosophy.

I think in an area where Federal Government resources are shrinking, the key to preserving service on light density lines in States like yours and mine lies in helping shippers acquire the expertise to deal with those problems in advance of crisis.

What I have tried to do at FRA—and I have one person doing this right now whose tail is run ragged, and I hope to be able to apply more people to it—is to have folks with expertise with finance and marketing available to go out and consult with and work with shippers because, Senator, in listening to some of the questions you asked the last panel, which I thought were very good questions—light density shippers gained something with Staggers, in that the cash flow of the industry made it less likely that cash would simply be pulled out of maintenance on light density lines.

Now, it is going to differ from railroad to railroad, depending on railroad management philosophy. But the real answer has got to be break even. They have got to be able to operate their services

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either with a class I railroad or with a short line on a break even basis, and it requires expertise, and I think the provision of expertise and sharing of knowledge is the most important thing we can do to help shippers, Senator.

Senator **Pressler**. We have found that in many States, such as South Dakota, the railroads often let the lighter density lines deteriorate by not investing any capital in maintaining the physical plant. Then the business of abandonment becomes kind of self-fulfilling prophecy; more and more shippers cannot depend on them. I have had machinery dealers say, well, we would use the railroad, but it is not reliable. More and more of the shippers turn to other methods, the track gets in worse and worse shape.

There is kind of a deliberate effort almost on the part of the railroads to create a situation that everybody says, well, we might as well abandon. The shippers get such bad service that they don't carry through.

There does not seem to be a standard, an administrative standard for determining the point at which divestiture should occur or at which abandonment should be allowed. Well, there is for abandonment.

But the point I am making is that you can kind of create a situation in which there is not a profit, or you can create a situation. For example, I am one who believes strongly that the Pierre to Rapid City in South Dakota could be made profitable. And I think the Chicago North Western has now turned around and is starting to make those efforts and shippers will have to use it. The same can be said of the Aberdeen to Oaks line. Both of these lines were denied for abandonment.

The point I am making is that a situation can almost be created by a railroad under which everybody just throws up their hands and says, well, we might as well abandon.

Mr. **Riley**. Well, we call that the spiral and I think there is a lot of validity to that, because with falling capital investment levels you get declining service, and with declining service it is hard to keep volume on the line.

One of the real crisis problems we had in 1978 or 1979 was that the industry was so cash-starved, they had to take all available cash and do what any rational businessman would do and throw it out on the main lines where they make their greatest return.

Since Staggers, we have had a 25-percent reduction in mileage filed for abandonment, a 14-percent reduction in mileage granted. But I don't think that tells the whole story because two things have happened since Staggers that are helpful, that we can now capitalize on if we have the ingenuity.

One of those, of course, is the right of the shipper to go in and buy the line, with a 10-day window period. And the second is the evolution of successful short lines.

I guess this is really a personal statement. I am a very strong believer that there is a lot of untapped shipping opportunity on many of these lines, Senator, and let me offer—I would be very happy to have some of our people work with you, and I am going to have to devote more people to this on those lines. I would be happy to send them out if you think they can be of assistance to you; I would be glad to do it.

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Senator PRESSLER. Well, that is, theoretically, a good idea to have the shippers buy the line, but frequently the line has been allowed to deteriorate so much, and also shippers don't have the expertise frequently to buy a line in a lesser populated area where they are spread out over a couple of hundred miles.

Mr. RILEY. I think that is absolutely right, and I think that the advice that I am always giving shippers on those lines is that your first recourse is to try to work with the class I railroad and stay within the system if you can do it.

The second recourse is to get a short line to come in and buy the line. You buy it and bring in an operator as the last recourse. That is the most difficult of all scenarios. And the key messages for people when they see the line, even before it is up for potential abandonment, with declining volumes, to organize at that point.

Senator PRESSLER. Now, there are a number of short line operators interested in South Dakota, one or two that are operating. But how viable would it be to require or encourage a railroad to sell a branch line at or below salvage value in order to help the short line purchaser overcome any capital investment shortfall?

Mr. RILEY. Well, the 10-day window period of the current law requires them to sell at net liquidation value. And that was put in there to make sure that the shipper does in fact have the opportunity to buy the line at the best constitutional price.

I am not sure that in a railroad unlike Conrail, which we are not subsidizing, we could require them to sell at below net liquidation value. If we could—I guess I would have to think about that, because you really are compelling a transfer, a taking. But I do strongly support the provision that requires sale at net liquidation value. I think that is in the public interest.

Senator PRESSLER. I do have some more questions for the record. On the question of the 10-day window where you have shippers who are not used to dealing in management of a railroad, it is almost impossible for them to act, get financing and get organized within 10 days. Even the U.S. Senate cannot get things done within 10 days sometimes.

So, since my time is up, I would like to ask three or four questions for the record.

Mr. RILEY. Thank you, Senator.

The CHAIRMAN. John, you have followed this area very closely. You know of the resolution that was introduced last year by a number of members of this committee. It was focused on the interpretation by the ICC of the Staggers Act.

To what degree do you think the ICC has been responsive to that resolution and to what degree do you think it has been unresponsive to it?

Mr. RILEY. Well, Senator, I think they have made an effort to respond to every provision in it. I think, as Reese Taylor went through that resolution this morning, that he said what I would have said in laying out what was requested and what they have done. And on the factual end of it, I won't go back over his testimony.

How well those solutions work, time will tell. Most of them are very new, some adopted even in the last several days, but I think that the Chairman made a compelling argument for giving them an opportunity to work, and I think he said forever is not forever, but that they have made an effort to respond to the committee and I am for giving them a chance to play out.

The **Chairman**. Well, you heard the comments of other Senators today, and clearly the ICC is being criticized, particularly by Senators who represent the coal-producing States. They want to be true to their people and they are doing a very effective job, I think, of pressing their point.

But the coal people are concerned; the utility people are concerned. Do you think that the ICC is gambling with the matter correctly, or do you think that they should change their policy?

Mr. **Riley**. Senator, I think at this point I would associate myself with the way the committee is acting today. In fact, I was impressed with the Senator's testimony. This is not the kind of issue, I think, on which you will ever have consensus. It is just the nature of the issue. And no rational person would say that the coal industry is not flat on its back today, but it is my view that you cannot resuscitate the coal industry effectively by placing the railroad industry back on its back.

It is important to remember that the revenue per ton mile the railroad industry gets from coal is lower than the revenue per ton mile it gets from any other commodity—from any other commodity. Eighty-five percent of the Nation's coal shipments move below that 180 percent threshold this committee established as the threshold at which no monopolist would price his goods.

And I think the real comparison has to be made in how the railroads priced coal pre-Staggers, how they price it today. The Department of Energy studied that in detail. I have not performed a study to that degree, but I think the conclusion I have reached from talking to shippers is the same as the one that they reached from analyzing it, is that the railroad industry has not abused its pricing flexibility. The railroad industry has in fact four times waived the rate adjustments it was entitled to make on coal shipments into the Tidewater area, because they recognized the reality of keeping that coal competitive if they were going to amortize their costs.

That is not to say that the coal industry does not face extremely difficult times today. It certainly does. But the railroad industry's recovery has not come at the coal industry's expense.

The **Chairman**. Do you think that it is reasonable for the ICC to conclude that there is no railroad that is revenue adequate?

Mr. **Riley**. Senator, let me talk about revenue adequacy. It is a complex concept and I am glad you asked the question and gave me the chance to talk about it.

There is a difference between revenue adequacy and profitability, and the best definition example case for the revenue adequacy standard the Commission has applied to railroads can be found in the arguments that utilities raise, and I think very properly raise in their own ratemaking cases.

We have so often seen the utility go in and say we are getting an 8 percent rate of return, but the prevailing cost of capital is 10 percent. If we cannot pay that to our investors, we cannot compete in capital markets.

That is what the concept of revenue adequacy is about. It is not a short-term cash flow figure. If the industry cannot pay a return to its investors that is competitive with the return that other industries pay, it is at a long-term disability in capital markets, that is a key measure to a capital-intensive industry.

And I have agreed for years with this argument when made by the utility industry. I do agree with if it were made by the railroad industry. I think NS and a couple of those are very close to revenue adequacy. They are not quite there. But what we have got to look at is whether, over the long term, any industry, railroad or nonrailroad, any industry that has to make capital investments, can pay enough of a return to compete for investor dollars that become increasingly scarce in an era of large Government borrowing.

The **Chairman**. Have you examined the so-called CURE legislation?

Mr. **Riley**. I have looked at the CURE legislation, Senator.

The **Chairman**. Do you have an opinion as to what that would do to the health of the railroad industry?

Mr. **Riley**. Well, I can comment on the CURE legislation in specific, but let me comment on it in general. What the CURE legislation would do would be to require railroads to go back more frequently to the Commission and shippers to go back more frequently to the Commission to deal with interpretations on rigid formulas.

One of the great arguments raised against the regulatory system, pre-Staggers, was that the industry lost about a billion a year in adjustments to rates that were ultimately approved because of the regulatory lag. The CURE legislation would put us back in that situation.

As you know, in my testimony I have stated that the Department is strongly opposing the legislative reopening of Staggers, and that we do not believe that can be done selectively because of the nature of the issue and the compromise that created it. And I would be glad for the record, since I see the time is up, to comment on any specific provision.

But we certainly do not support that approach.

The **Chairman**. Senator Pressler.

Senator **Pressler**. I just have a couple more questions, one of which you can answer for the record.

I would like to ask you—if you can't do it here, do it for the record—to take sort of a case study of the two South Dakota examples; one, the Rapid City to Pierre line. and the other from Aberdeen to Oaks, ND, both of which we have done a lot of work on and have been denied abandonment. We now have the problem of working with the State, the shippers, the carriers, labor, and local communities in order to make these otherwise difficult lines viable.

What steps can we take toward helping preserve these lines, and what can we do to encourage that process? And I would add to that question for the record—and this is a broad question here—my earlier one about how viable would it be to require or encourage a railroad to sell a short line at or below salvage value. And you mentioned that it might be a taking without due process. But, on the other hand, these railroads are a public utility to some extent, in that they are going to be operated, and those two are critical to our State, especially the West River line from Pierre to Rapid City is the last Statewide rail line that is viable connecting our State.

And my office is working with the other congressional offices and shippers, struggling to save those. But I think that they represent the fringes, the real problem we have in the sense that they are from lesser populated areas. A lot of these examples assume that a short line can take up a fairly prosperous, maybe suburban areas that are called rural under the Census definition, but this is the real rural.

Do you have some comments on that? I guess specifically again on the below salvage value to help the short line, or what new things can be done if the railroad, if the carrier is going to stay, to make them profitable?

Mr. RILEY. Senator, I will be glad to look at both of those and take a look at the salvage value question which was kind of a gut reaction on my part on the taking, because I have not given a lot of thought to that, and I will be glad to submit whatever you would like for the record.

Senator PRESSLER. I think those two—and we would appreciate your submitting for the record on those two, especially the Pierre to Rapid City line which is just critical to our State, and we are struggling very much.

Mr. RILEY. I will be glad to do it, Senator. We will work with you and your staff on it in a positive sense. If we do come up with anything constructive, we will be glad to do that.

The CHAIRMAN. Thank you very much. There is another vote on the floor of the Senate.

[The statement follows:]

STATEMENT OF HON. JOHN H. RILEY, ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATOR

Six years ago, the fifth Federal Railroad Administrator—Jack Sullivan—came before this Committee on the very same issue that we meet on this morning. Jack was a Democrat, of course, and I am a Republican. We represent two very different Administrations. But our position on this issue is virtually identical, and because this Committee both shared that view and took leadership in transforming it into reality, America's railroads are very different today than they were in 1979. To assess the real impact of the Staggers Act, it is essential to bear in mind where we were six years ago, and contract that environment with the industry we know today.

When Congress debated the Staggers Act, nearly one-quarter of the nation's track was in bankruptcy reorganization. The relatively prosperous 1970's had witnessed the failure of 9 major carriers, coupled with a complete collapse of regional systems in the Northeast and Midwest.

Even the strongest railroads had a tenuous hold on stability. Return on investment (ROI) industrywide hovered at about 1 percent. Because investment needs had outstripped retained earnings for eighteen of the previous twenty years, the industry faced a ten year capital shortage in excess of $13 billion. The railroads were on their knees, and nationalization was frequently discussed as a serious policy alternative.

There were no winners under the regulatory system this Committee altered in 1979. The problems afflicting the railroads touched every rail shipper, every community served, and virtually every employee.

Rural shippers were hit by branch line abandonments as the railroads focused their declining resources on the heaviest density lines.

Poor cash flows meant deferred maintenance, which translated into car shortages, derailments, and unreliable service. Train accidents in a cash starved industry were three times as high as they are today. In fact, the late 70's brought a new accident category to FRA's reporting data—the standing derailment, in which a freight car, standing perfectly still, simply fell off a track. That, believe it or not, occurred twice in a single year.

The contrast between then and now is the best testimony to the wisdom of the decisions made in this room six years ago. Today's rail industry is healthy and profitable on an industrywide basis. It survived the deepest recession since the 1930's without a single bankruptcy. Capital investment has increased dramatically, rising even in the deep recession year of 1982.

I cannot represent that the industry has eliminated every dollar of the $13 billion capital gap, but deferred maintenance has been virtually eliminated from the nation's main lines, and the pace of branch line abandonments has slowed.

The so-called "box car shortage" evaporated when legalization of shipper contracts enabled carriers to plan the utilization of their equipment. The number of covered hopper cars is at an all-time high.

The industry's return on investment has increased fivefold to the lofty figure of 5.7 percent—a revealing figure, because it tells both sides of the story. This 5.7 percent is certainly a dramatic increase from the 1 to 2 percent levels of the past twenty years. But it is still less than the return an investor could receive by simply depositing money in a savings account. As the nation's utilities have argued so persuasively—and correctly—in their own rate cases, an industry that cannot generate a return on capital equal to the cost of borrowing is an endangered species. These ROI figures emphasize the extent, and at the same time the fragility, of the industry's recovery. The progress is real, but it can be easily eroded.

In assessing the impact of these accomplishments on national policy, it is essental to recognize that no one has gained more from the railroads' turnaround than the railroad shipper.

It was only a few years ago that "railroad marketing" seemed to be a contradiction in terms. Today, price and service innovations like multiple car grain rates, just-in-time service, and reduced rate back hauls have become standard shipper benefits. Shippers have used the power to contract to lock in rates and service commitments in more than 30,000 shipper contracts. I am convinced that we have only scratched the surface of what the industry will accomplish as it becomes more accustomed to marketing in a deregulated environment.

In addition to becoming more price competitive, railroad service has become more reliable. The industry moved the near record grain harvest of 1984 without the costly bottlenecks that plagued shippers during the harvests of the 70's. Agricultural equipment shortages largely disappeared after the onset of contract rates. The elimination of deferred maintenance from the nation's main lines has meant more timely and reliable service for shippers of time sensitive commodities.

Shippers have also shared in the public benefits of the Staggers Act. The industry's financial recovery has enabled the Federal government to cut its expenditures on rail freight assistance from $1.99 billion in fiscal year 1978 to $64 million appropriated for fiscal year 1985. And with stronger capital investment levels has come an historic improvement in railroad safety. Train accidents have been cut by two-thirds since the adoption of the Staggers Act, an improvement that tracks across every reportable accident category. As the industry's financial picture continues to solidify, these numbers will grow better.

Simple statistics make it indisputably clear that the railroads' improved financial condition has not come at the shippers' expense. Rather than simply increasing prices across the board, railroads have utilized their new-found pricing flexibility to attract a greater share of existing markets, and provide competition for commodities—like perishables—for which they had been noncompetitive for decades. This base broadening, along with more efficient equipment utilization made possible by deregulation, enabled the industry to increase its cash flows while cutting the rate of increase in rail rates by more than 50 percent. Statistics tell that story in clear, hard numbers.

During the five years preceding the Staggers Act, rail rates rose by an annual average of 10.6 percent. In the first five years after Staggers, the rate of increase has been cut in half, to 4.6 percent. Over the past twelve months, competitive pressures in a deregulated environment have held the rate of increase to less than one-half a percent—far below the rate of inflation. And even these numbers understate deregulation's benefit to the shipper, because they measure primarily published rates—not contract rates, which are lower and longer-term. A recent study done for the railroad industry by an independent accountant surveyed rates for more than 80 percent of rail carried grain tonnage, and found that—when contracts are added into the equation—grain rates have actually declined by 18 percent since passage of the Staggers Act.

Coal shippers and utilities have entered more than 1000 long-term contracts, and to assist Tidewater coal shippers the rail industry has four times voluntarily forgone the inflation adjustment it was entitled to under Staggers Act provisions. The result: the railroads' coal revenue per ton mile has actually decreased over the past three years (from 2.6 cents to 2.4 cents), and rail rates for coal are lower today in constant dollars than they were in 1972.

But perhaps the best testimony to the success of the Staggers Act lies not in what it has accomplished, but in what it has not produced. Because it is simply fact that the dire consequences feared by critics when the Act became law five years ago have not materialized.

Rates did not skyrocket, even when the economy came out of the deep recession of 1982. They are rising more slowly today than at any time in the last two decades.

Short line carriers have not disappeared. Their numbers are growing at record rates, and they have prospered with the marketing flexibility made possible by the Act. The marketing choices available to shippers today are unequalled by any in the industry's history.

I have no intention of representing to the Committee that these changes, for all their benefit, came easily or painlessly. The Staggers Act changed shipping and pricing patterns that had been established for nearly a half century. There were pains of transition. There are, in fact, hard cases which must be addressed on a case-by-case basis. And the existence of the captive shipper is a reality, not a myth.

But the theme that should come through clearly from an oversight of the Staggers experience is that the railroad industry has not abused its pricing and marketing opportunities, and because of those opportunities, has become stable while providing better shipper service. It should also be clear that while no system dependent on human judgments will ever be flawless, allowing the commercial relationship between shippers and carriers to be shaped by market forces produces better results, for shippers and carriers, than a system which delegates the major share of those decisions to a board of political appointees.

Perhaps, in the end, the most significant accomplishment of Staggers lies in the fact that it has forced shippers and carriers to work directly with one another, to address their own problems and develop their own compromises. The success of that system can be measured in 30,000 contracts, and in the historic agreements between the National Industrial Transportation (NIT) League and the Association of American Railroads (AAR) on the difficult issues of joint rates, and product and geographic competition. In contrast, a system in which ultimate pricing and contract decisions must be referred to an appointed board of arbitrators is a system which creates incentives for the parties to defer, rather than resolve, the issues of greatest importance in their relationships. It was a slow and cumbersome process, one in which marketing is done by rate attorneys and ICC practitioners. It was a process that served the public and the shipper poorly.

This Committee showed great wisdom in adopting the Staggers reforms six years ago. They have enabled a partially deregulated railroad industry to compete effectively with a deregulated truck industry and largely unregulated barge industry. There have been transition pains and hard cases, as there inevitably will be in any system. But they do not imply a structural or systemic weakness in the Staggers reforms. The ICC has both the authority and the tools to resolve such problems on a case-by-case basis.

We do not believe that the Staggers Act can be reopened selectively. The Department of Transportation strongly opposes legislatively reopening the Staggers Act because the structure of that Act has worked. It has delivered enormous benefits to shipper and railroad alike. It is one of the great bipartisan accomplishments of our time—proposed by a Democratic President, and defended by a Republican Administration. And I look forward to mainaining that bipartisan spirit in working with you to make certain that no railroad Administrator, Democrat or Republican, will ever again have to make the kind of arguments that Jack Sullivan made in 1979.

[The following information was subsequently received for the record:]

QUESTION OF SENATOR PRESSLER AND THE ANSWER

PRESERVING RAIL SERVICE ON LIGHT-DENSITY LINES

You have asked what steps the State, shippers, carriers, labor, and local communities can take to help preserve rail service on light-density lines such as those between Rapid City and Pierre, South Dakota, and between Aberdeen, South Dakota, and Oakes, North Dakota. Most light-density branch lines that are in danger of losing the service provided by major rail systems have reached that stage because revenues generated by the line do not cover the costs of operation plus a reasonable profit. In the most simple terms, the solution to the problem is to increase revenues and/or decrease costs. Of course, in the real world, such solutions are not easy to develop. Clearly, the carrier has the primary responsibility of marketing the rail service and reducing its operating costs; however, there is a role for shippers, communities and labor. Their role is to work with the carrier to incorporate cost-effective and innovative methods of service that will attract revenue-producing traffic and improve the economic performance of the branch line. The states and communities must also determine whether it is in the interests of their constituents to provide financial assistance to help in these efforts.

Every line is unique; therefore, I cannot provide a specific answer for preserving service on all lines. Indeed, some light-density lines cannot be made viable. But from our experience with successful efforts to turn around light-density lines, the common thread seems to be that all interested parties were working together to develop solutions to the unique problems of their line.

One type of solution that has worked effectively in a number of light-density areas is the establishment of an operator other than a Class I carrier. The economies of a smaller carrier can often mean that service can be preserved on a profit-making basis, even though such service cannot be economically provided by a Class I carrier. In the past few years, the larger rail systems have begun to recognize the value of the feeder and delivery functions that the smaller carriers provide, and the Class I carriers themselves are now taking an active part in seeking and encouraging independent short-lines of regional railroads that can maintain service on light-density lines that might in earlier years have been abandoned. Two recent examples are the Gulf and Mississippi in eastern Mississippi and the Chicago Central and Pacific Railroad in Iowa and Illinois (the latter currently subject to ICC approval), both formed from lines of the Illinois Central Gulf system.

The Chicago and North Western Transportation Company (CNW), operator of both the Pierre-Rapid City and Aberdeen-Oakes lines, has recently announced that it will negotiate to sell more than 870 miles of its lines in South Dakota and Minnesota, including those two lines, to the L.B. Foster Company for the purpose of establishing a regional railroad that would take responsibility for operations on the lines. The concept is new to most of the parties involved and the negotiations are complex, so an agreement may not be reached immediately. However, service is continuing, plans for abandoning the lines have been set aside, and all the affected parties are working together to devise a solution that will best accommodate their varied interests. I believe that this is the most effective and appropriate course for preserving both profitable and economical rail service for South Dakota shippers.

The Federal Railroad Administration is prepared to offer our technical expertise in finance and marketing to the state, shippers, carriers, local communities or other parties involved in this effort, if it would be of assistance. I would like to also add this observation. FRA has had extensive experience with short-line and regional railroads. In the final analysis, it is the commitment of the shippers and communities to the locally-oriented railroad that is usually the largest single factor in determining whether the operation will be a success.

You also have asked whether it would be desirable to require a railroad to sell a line at or below salvage value, in order to assist a short line to take over operations. I believe that, for these purposes, the term "salvage value" is synonymous with the term "net liquidation value." In a long line of cases under the Fifth Amendment of the U.S. Constitution (specifically the clause concerning the "taking" of private property without just compensation), the courts have found that the net liquidation value is the constitutional minimum that the Government can require a railroad to accept for the sale of a rail line that has no going concern value and is approved for abandonment. Where a rail line still has value for rail operations, the constitutional minimum value has been established as either the net liquidation value or the going concern value, whichever is the greater. The constitutional minimum value sets the floor on the price that the United States Government can require any private party to accept for the sale of property without violating the Fifth Amendment.

If it is in the public interest to transfer ownership of a rail line to a party who cannot afford to pay the price of the rail properties, the only appropriate means for a governmental body to assist the prospective purchaser is to help the purchaser directly to put together the purchase price. It would not be constitutional to require a railroad to accept less than the net liquidation value of its properties, and the Congress should not expose the Federal Government to liability under the Tucker

Act from a forced sale of private property at a price below the constitutional minimum value.

The owner of rail property may find that good and valuable considerations will arise from the sale of specific properties to other carriers or interests, and in such a case may agree to a sale at less than the net liquidation value. Such a decision must be reached voluntarily, however. I believe that, to the extent possible, negotiations for the transfer of privately owned rail lines must be kept in the private sector, with the affected parties determining a fair price for the properties involved.

The CHAIRMAN. When we return, Mr. Brien Benson, Director of the Office of Policy, Planning and Analysis, Department of Energy, will be the witness.

Mr. RILEY. Thank you, Senator.

[Recess.]

Senator PRESSLER [presiding]. I will now call Mr. Brien Benson, Director, Office of Policy, Planning and Analysis, Department of Energy, for his statement.

And let me say that from a personal point of view, I have asked each of the witnesses to give me their specific recommendations on two of our problems in South Dakota, two of our problem lines, and have asked them to submit that in a day or two, because I think these are classic examples of the problems under the Staggers Act.

But in any event, Mr. Benson, go ahead.

STATEMENT OF BRIEN BENSON, DIRECTOR, OFFICE OF POLICY, PLANNING AND ANALYSIS, DEPARTMENT OF ENERGY

Mr. BENSON. Thank you, Mr. Chairman, and I appreciate the opportunity to testify here on the study by the Policy, Planning and Analysis Office of the Department of Energy on the effect of the Staggers rail deregulation on the coal and electricity industry.

I think it is worth underscoring that coal is a vital ingredient of our national economy. And just to remind us all here, 55 percent of electric power in the Nation is generated from coal. We project that that will be moving up toward 60 percent in the early years of the next century. And, of course, coal has additional uses for direct production of heat, for exports, and for metallurgical purposes.

We certainly feel that despite current weaknesses, it is still fair to characterize coal as the fuel of the future. The policy, planning and analysis study focused on the underlying goal—the underlying policy objective of the Department of Energy, of adequate energy supplies at reasonable prices.

To summarize our findings, under Staggers, as has been testified to at great length already this morning, rail maintenance and productivity have significantly improved, which of course is a benefit to shippers. Rate increases have been modest. If one looks at 1976-80 adjusted for inflation, coal rates increased 3.3 percent; in the 1980 to 1984 period, this dropped to 0.5 percent per year. And if one adjusts for rail operation costs rising, as opposed to the general consumer price index, that annual increase was only 0.2 percent.

The CHAIRMAN [presiding]. Can you speak a little closer to the microphone?

Mr. BENSON. Yes; certainly, Senator. Thank you.

Now, to be sure some significant downward pressure may have been exerted on these rates by the soft market for coal, and it is true that in coming years tightened demand could change this. On the other hand, in the future long-term opportunities for coal's main customers—utilities—to find or even to threaten to find new coal sources, to switch fuels, or even in the long run to switch plant sites, should maintain some kind of downward discipline on rates.

Now, to be sure, as has been recognized, the problem of captive shippers is a serious one. There are a wide range of definitions of captivity, and therefore there are a wide range of perceptions of the scope of the problem. But in any case, the problem clearly warrants attention.

The policy, planning and analysis study looked at 34 cases of market dominance pricing to get some kind of a fix on the problem. We do not claim that these were necessarily representative cases. These cases were presented almost exclusively from industry. The study found several cases of above average increases, which is not surprising to us, of course, with the differential pricing doctrine that was being used.

But in only a few cases did the increases exceed or equal 4 to 6 percent annual rate, the rate which would trigger an ICC investigation.

At the same time, the study reviewed numerous captivity proposals and these have been commented on widely. I would like to comment that we consider these analyses to have been extremely useful, but I do want to emphasize the ICC and the Railroad Accounting Principles Board have regulatory accounting expertise and we certainly don't claim to be matching that level.

In this regard, we do want to commend the ICC for the recent moves which, of course, were discussed at great length this morning. In particular, the shifting of burden of proof in market dominance on both the product and geographic competition is a major step forward. In the stand-alone cost area, clarifying shippers' rights to include both group shipping and slurry pipeline alternatives is a significant step forward, and also extending Long-Cannon provisions to include the question of rail inefficiency, both in operations and in planning, we consider to be significant.

Issues remain, including the question of revenue adequacy. I have met with the staff of the ICC, at DOT, and Rail Accounting Principles Board, and we will continue to meet with these agencies.

To summarize, under Staggers there has been significant improvement in rail service with only moderate rate increases. It is true that tightening of coal markets in the future could push rates up, but there are countervailing long-term competitive forces, including source and fuel switching.

We currently do not see any need to revise the Staggers Act. Nevertheless, the captive shipper issue remains, and we will continue to work with relevant Government agencies to see that the national energy policy issues are adequately addressed.

Thank you, and I would be happy to entertain any questions.

The **Chairman**. Thank you.

Senator Pressler.

Senator **Pressler**. Let me say that, first of all, some of the previous questions I have asked might also apply in the sense of the very light density lines such as those in my own State of South Dakota. I have been pounding away on that in terms of transportation and in terms of the Staggers Act.

I don't know—you are probably not familiar with our Pierre to Rapid City line or Aberdeen to Oaks lines.

Mr. BENSON. No, sir. I am not familiar with either of those issues. I am not even familiar with the degree to which coal is impacted there.

I would be happy to review this and get a response to you for the record.

[The following information was subsequently received for the record:]

The two lines you mention are on the Chicago and Northwestern Railroad, and according to the data we have, little to no coal is moved over those lines. The three coal-fired power-plants located in South Dakota are serviced by the Burlington Northern.

Senator PRESSLER. Fine. I would very much appreciate that.

I could also ask you two questions: One, on the revenue adequacy issue, a question I have asked earlier witnesses, I don't know if you are prepared to discuss the drawbacks of the ICC's current revenue adequacy criteria. And also discuss the problem of short and captive track segments, and what the Department of Energy recommends as a solution.

Mr. BENSON. No. What the Policy, Planning and Analysis study attempted to do was to highlight some of the problems with ROI and to look at some of the—whether an ROE approach or an ROI approach that included embedded costs would be more appropriate. The study—which, I might add, does not represent DOE policy; it is a staff study—but the study did not make any conclusions.

My personal feeling is that the best way for us to proceed is to continue to work with staff at ICC and RAPB, but I certainly don't have the expertise to comment intelligently on the relative merits of the different financial and analytical techniques.

Senator PRESSLER. Thank you very much. I may have one or two more questions for the record.

The CHAIRMAN. Mr. Benson, you said that you have been discussing matters of coal rates with the ICC, I take it, over a period of time?

Mr. BENSON. Well, Senator, I should say, first of all, I am new. I have been in my current position for 2 months, but our staff has over some period of time. Yes, sir.

The CHAIRMAN. Has your staff found the ICC to be unreasonable or intractable or oblivious to the needs of coal shippers?

Mr. BENSON. Quite the contrary. We have maintained very good working relationships with them and I certainly feel that the steps that have been announced in recent months reflect the sensitivity to this problem, and we certainly look forward to their continued progress.

Of course, as the Chairman testified this morning, he views this as an ongoing process, and we certainly take him at his word.

The CHAIRMAN. Thank you very much, sir.

[The statement follows:]

STATEMENT OF BRIEN BENSON, DIRECTOR, OFFICE OF POLICY, PLANNING AND ANALYSIS, DEPARTMENT OF ENERGY

The Policy, Planning and Analysis staff of the Department of Energy undertook in mid-1984 the study "Effects of Railroads Regulatory Reform on Coal and Electricity"—in order to bring some clarity to the debate on the effects of the Staggers Rail Act of 1980.

The study shows that, under Staggers, railroad finances and operations have improved substantially, while rates have increased only modestly. Furthermore, we can expect that in the long run competitiveness within the coal industry, the possibilities for fuel switching away from coal, and the chance for utilities to select new plant sitings should maintain market discipline on rail rates.

Nevertheless, "captive" coal shipments are potentially subject to monopoly pricing, and deserve regulatory review. While we do not believe that legislation is necessary, we are continuing our analysis of these questions, and will continue to work with both the Interstate Commerce Commission and the Railroad Accounting Principles Board to present energy policy perspectives.

Good morning, Mr. Chairman, and Members of the Committee. I appreciate the opportunity to speak with you this morning on the subject of coal transportation and, in particular, the Office of Policy, Planning and Analysis' draft study "Effects of Railroad Regulatory Reform on Coal and Electricity."

Allow me to first put in context this report. When Congress passed the Staggers Rail Act in 1980, it intended to address, in a fundamental way, the financial decline that had been affecting the railroad industry for several decades. It was widely recognized that railroads were burdened with a host of regulatory and legislative constraints on pricing and operating decisions, and that such constraints were continuing to sap the strength of the railroads.

It was also widely recognized, by shippers as much as by the railroads themselves, that a healthy rail industry is essential to America's economic health, and in particular to producers of bulk commodities, such as coal, that involve lengthy shipment to market. So a wide range of interests, including the coal industry, advocated passage of the Staggers Act.

Not surprisingly, implementation of the Staggers Act has met with less of a consensus. Inevitably, such sweeping legislation disrupted established patterns and prices of shipping. These disruptions created numerous calls for redress of grievances, ranging from the highly specific to broad-reaching proposals. Accompanying such proposals has been a welter of statistics from numerous sources.

In mid-1984 the Policy, Planning and Analysis division of the Department of Energy commenced a staff study of the subject—primarily for the purpose of untangling the various allegations and statistics in which this controversy had become entwined.

The office was concerned about the possibility that partial rail deregulation could increase electricity prices and potentially disrupt the progress the nation has made in diversifying our sources of energy by relying more heavily on coal. Coal provides almost one-quarter of the energy consumed in the U.S.—up from about a sixth of the market in 1974. In 1984 coal was the energy source for about 55 percent of the electricity produced in the U.S., and we expect this percentage to increase.

It is important to emphasize that the focus of the study is energy policy and the Department's goal of adequate energy for America at reasonable costs. We have not aspired to be regulatory accountants. While the study addressed a variety of regulatory rail accounting issues, we are the first to acknowledge that such issues are not our area of principal expertise, and that primary responsibility for addressing such matters lies with the Interstate Commerce Commission and the Railroad Accounting Principles Board.

To turn, then, to the study's findings, it appears that the primary goal of the Congress in passing Staggers—an operationally and financially healthy rail system—it being achieved. Shippers and carriers agree that the backlog of maintenance that once inhibited rail operations has been erased. Productivity, as measured by ton mile per employee, per mile of railroad, and per unit of equipment, is trending upwards.

Railroad profitability has improved, although rates of return were still below those of many other industries through 1983. Improved rail profitability in 1984 is really not surprising, given the large volumes of coal shipped and generally strong national economic performance in that year.

Although not all of the improvements in the national rail system are soley attributable to the Railroad Regulatory Reform and Revitalization Act (4-R Act) and the Staggers Rail Act, it does appear that the emphasis on relying on the market and on standard business practices to establish rail rates has created an environment in which railroads can become more efficient.

The second basic finding of the Policy, Planning and Analysis Study is that rail rates for coal as a whole have not increased significantly, when adjusted for inflation. Data from the Bureau of Labor Statistics indicate that since the 4-R Act, real rail rate increase averaged 3.3 percent in the 1976-1980 period and a half of a percent per year in the 1980-1984 period. When compared to increases in the costs of running a railroad, rate increases have been even lower—0.2 percent annually from 1980-84.

I cannot tell you how much rates have changed for various classes of shippers, because rates established by contracts, which were formally sanctioned by the Staggers Act and which now cover about 55% of all coal shipments, are confidential. However, published reports indicate that many shippers have been able to negotiate rates that are lower than their published tariffs. The national average may obscure the fact that rates for some shippers may have risen by an above average amount.

In the years since passage of the Staggers Act, overcapacity in the coal and electric utility industries has allowed some utilities to shift away from "captive" plants and mines. This flexibility has provided some leverage for limiting the monopoly power that the railroads might otherwise be able to exercise over coal transportation. Such flexibility may well diminish in the future if electricity and coal supply tightens.

Furthermore, there is concern among many shippers that, while their rates may not have risen sharply in the last half decade, the railroads have been "on good behavior" for various short-run political reasons and because they are still "feeling their way" in a deregulated environment. These shippers worry that the passage of time may erode the pricing restraint of the last five years. Some shippers are also concerned that further mergers and consolidations in the rail industry could lessen competition and therefore lead to possible rate hikes.

We are sensitive to such concerns, and will continue to monitor the situation. At the same time, current "good behavior" by railroads may reflect underlying market forces. Knowing that coal rates that are high enough to cause a shift from coal to other fuels for generating electricity or to suppress electricity demand will ultimately result in a loss of traffic and revenues, railroads have the incentive to moderate rate hikes. The intense competitiveness in the coal industry should provide further discipline on the railroads. Furthermore, as new coal supply contracts are negotiated, and new power plant sites are selected, the record of various railroads in their pricing policies will inevitably be considered. Such a prospect should provide further discipline on the railroads.

Despite all these competitive forces, there will remain "captive" shippers, who are vulnerable to monopoly pricing. Congress recognized this problem and specifically directed in the Staggers Rail Act that a regulatory backstop be provided to protect captive shippers from unreasonable rate increases. This regulatory protection is important to captive shippers because these shippers did not choose to be captive; rather their situations are the results of fuel choice and siting decisions made long ago in a different planning and regulatory environment.

Unfortunately, captive is a term far easier to use than to define. By one definition—powerplants lacking access to more than one delivery option—we estimate that about 40% of coal shipped to utilities is captive. On the other hand, an ICC study suggests that if alternative forms of transportation—trucking, conveyor, water carrier or increased track access—were used for up to the last 25 miles of the haul, "captivity" would be 13%. It is unclear how realistic such an approach is; however, product and geographic competition could lower the estimates of captive shipments in either case. In general, the further into the future one looks, the greater are the opportunities for shippers to avoid captivity.

Whatever the exact percentage of captivity in coal shipping, the situation warrants attention, and the Policy, Planning and Analysis study tried to determine the cost of monopoly or semi-monopoly pricing. The study team interviewed nine utilities and examined over 15 additional cases, all of which were considered "captive" by representatives of the electric utility industry. The team found that rates had increased for some of these shippers but in only a few instances were those increases at or above 4-6 percent annually, the level authorizing independent ICC investigation under Staggers. Some captive shippers allege that their rail rates were already unreasonably high before the Staggers Act took effect. The ICC has not yet determined the reasonableness of any pre-Staggers rail rates for coal traffic where it has found railroad market dominance. On September 3, the ICC issued its final decision on ex parte 347, Coal Rate Guidelines. It will now be easier for the ICC to determine rate reasonableness on pending cases for pre-Staggers rail rates for coal.

The captivity problem has spawned a variety of proposed solutions, including adjustment to railroad "revenue adequacy" calculations, simplification of market dominance tests, changes in "rate reasonableness", refining the Rail Cost Adjustment Factor, providing eminent domain legislation for slurry pipelines, and adopting one of various trackage right proposals. Much of the Policy, Planning and Analysis study is devoted to spelling out such proposals and pointing up their pros and cons. While the study has provided much useful information, and has been well-received in many quarters, I want to emphasize that none of it should be considered Department of Energy policy.

The ICC and the Railroad Accounting Principles Board have the lead on these issues. I have already met with key staff at each agency, and intend to maintain a working relationship with both agencies. I believe that the Railroad Accounting Principles Board has the potential for clearing up substantial ambiguities and misunderstandings about important accounting issues that underlie regulatory standards for rail rates, particularly in regard to the proper allocation of costs.

I am also encouraged by the progress that the ICC is making in adjusting its regulations. For example, the Commission has recently proposed a change in the approach for determining "market dominance." The proposal would simplify the process of determining "captivity" by shifting to the railroads the burden for proving the existence of the two forms of competition most difficult to measure: Product competition (i.e. whether a shipper can use another type of fuel or purchase electricity) and geographic competition (i.e. whether a shipper can get coal from another source).

In addition, several changes in the recently released Coal Rate Guidelines appear helpful. The Commission has expanded its description of arguments relevant to whether railroads are operating efficiently, as required under the Long-Cannon Amendments. Also, the new guidelines clarify that a shipper may establish a group of shippers for the purpose of calculating stand-alone costs. In addition, a coal shipper may use a slurry pipeline as a surrogate for competition to the railroad. I share, however, concerns of both shippers and some Commissioners that some of these new tools available to shippers could be costly to employ.

In summary, we believe that the Staggers Act has made a major contribution to restoring the financial and operational health of the rail industry, which is to the benefit of coal shippers. At the same time, the rise in average coal rail transportation rates has been modest. While improved demand for coal in the future might encourage rail rate hikes, numerous long-term possibilities for coal source switching, fuel switching and new plant sitings should help discipline such rates. We do not currently see any need to revise the Staggers Act.

On the other hand, there remain problems for captive coal shipments. Various proposals to address these problems have been made, and the Policy, Planning and Analysis division of Department of Energy will continue to review these and to work with the appropriate regulatory and advisory bodies—the ICC and the Railroad Accounting Principles Board—to evaluate the enery-related aspects of these questions.

This concludes my prepared testimony. I will be happy to answer any questions you may have.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR LONG AND THE ANSWERS

Question 1. Your Department of Energy study found no abuses of railroad rates for shipping captive coal. Please tell us what you concluded about the railroad's costs of hauling coal. What has happened to those coal hauling costs for the railroads since the 4R Act? Since the Staggers Act.

Answer. Estimating rail costs is a very difficult and controversial procedure. Accurate cost estimates for individual moves cannot be based on Rail Form A revenue to variable costs. Accurate costing for a specific coal movement is complicated and far beyond the scope of this study.

At the system level, railroads argue that they have cut costs to improve their competitive position in a deregulated environment. Their improved financial condition, relative to the condition when the Staggers Act was passed, combined with the magnitude of inflation adjusted rate increases in recent years (0.5 percent per year between late 1980 and late 1984), support these claims. It is also important to note however, that such improvements cannot be traced to individual commodities without extensive further analysis. Railroads carry numerous commodities which may have been subject to vastly differing changes in costs as improvements in rail efficiency have occurred.

Question 2. What did you conclude about the relationship of those costs to the rates railroads were charging?

Answer. As discussed in question 1, PPA's assessment of the reasonableness of rate increases is based on (1) the poor financial condition of the railroads at the time the Staggers Rail Act was passed, including projected railroad revenue needed to become financially viable; (2) the improvement in the financial condition of the railroads since that time; and, (3) the magnitude of rate increases to date.

The study did not draw strong conclusions about the relationship of individual rates to the costs of individual moves, in part because of the data problems described in Question 1. In addition, it should be recognized that the economic principles underlying the Staggers Rail Act imply that individual rates will not necessarily be very directly related to the variable costs of providing the applicable service.

The Staggers Act acknowledges that it is appropriate for a carrier to consider the competition and the demand for services in establishing rates. This approach, known as differential pricing, was permitted because economic analysis indicates that is an efficient way of enabling railroads to cover their total long-run costs of operation. Differential pricing implies that those with fewer options are likely to pay higher rates, i.e. rates that may be substantially higher than variable costs. In other words, rates for all shippers do not have to provide equal contribution to long-run fixed costs to be considered reasonable.

Under a system of differential pricing the relationship between the rate and variable cost will vary according to the competitiveness of the move. A rate for a captive shipper will cover the variable cost associated with the move and make a larger contribution to covering the cost of investments (i.e. fixed costs) and profits than rates for shippers with more competition for their moves. In contrast, the rate for a very competitive move may only exceed variable cost by a small margin.

This system of pricing is used to assure that the railroads operate as efficiently as possible and still stay in business. Raising the rate for more competitive moves would probably result in a loss of the move and the revenues from it. On the other hand, if rates on all traffic were set so that all shippers made an equal contribution to fixed cost, they would lose competitive traffic and the railroad would probably not cover fixed cost and would, therefore in the long run have to go out of business.

Question 3. Do you think the ICC's revenue adequacy test ought to be changed? Do you have any reason to believe it will be changed?

Answer. PPA's analysis compared the ICC methodology to the methodology used for assessing the revenue needs of the electric utility industry. PPA found the ICC revenue adequacy test was more generous in its estimates of the revenue required to be deemed financially viable than the method used in the electric utility industry. It is not clear, however, whether the same methodology for determining financial viability should be applied to both industries. Because this is a very important and complicated accounting issue, the Railroad Accounting Principles Board will be reviewing it. The Board has the technical expertise needed to evaluate this issue.

Question 4. In the course of your study, did anyone talk to the Department of Energy's own Transportation Operations Staff? Were you aware that in March 1981, the Department of Energy itself filed a complaint at the ICC, alleging that the railroads were charging the DOE unreasonably high rates for shipments of spent nuclear fuel and associated equipment? Did you know that your own Department calculated that it was paying rates ranging from 871% to 1220% of variable cost? Did you know the railroads tried to argue that the Department could ship these items on trucks even though they exceeded weight and dimension limitations for the Interstate Highways? Did you know that the Administrative Law Judge found that your own Department was being charged rates at 436% to 797% of the railroads' fully allocated cost? Did you know that the Department's case is still pending at the ICC and will in all likelihood be decided under the *Coal Rate Guidelines?* Doesn't that suggest to you that there are railroad abuses of captive shippers? Doesn't that suggest to you that captive shippers don't have a remedy at the ICC? Do you think the taxpayers are going to win that case based on stand-alone costs?

Answer. Yes, PPA is aware of the complaint filed by DOE regarding the rail rates for spent nuclear fuel and the arguments made to support that claim. DOE's complaint, like many others that have been before the ICC, was filed under the Savings Provision of the Staggers Rail Act (Section 229, codified as 49 U.S.C. 10701(a) nt.) This provision specifically stated that any rate not challenged within 180 days of the passage of the Staggers Act could not be challenged thereafter. Because most everyone was uncertain about the method that would be used to determine the reasonableness of rates in the post-Staggers period, many shippers took this last opportunity to challenge their rates. As the report describes, shippers who challenged their rates during the period when the regulations required to implement the Staggers Rail Act were being defined, have often had difficulties.

A large part of the evidence in the DOE case centers around the operational requirements that the railroads claim are necessary to handle the particular spent nuclear fuel in question. The railroads attempt to justify their cost by relying on their assessment and conclusion that this spent fuel is very costly to move.

With respect to the market dominance issue and competition, the ICC has consistently held that the railroads are market dominant in the carriage of the DOE spent fuel. The railroads raised the argument that trucking might be appropriate early in the market dominance proceeding and subsequently abandoned it when it was found to be impracticable.

The ICC has stayed the DOE spent nuclear fuel case until such time as the Coal Rate Guidelines are finalized. DOE filed an appeal with the Commission objecting to the stay and requesting that the Commission apply rate levels in this case that it found to be reasonable in an earlier case.

Question 5. Do you think captive coal shippers can now win cases at the ICC? What makes you think coal rates are going to be moderated or disciplined when the ICC keeps insisting that all these coal-hauling railroads are revenue inadequate and need more, not less, money from their captive shippers?

Answer. As discussed under question 3, the Railroad Accounting Principles Board will be reviewing the revenue adequacy test. However, it is important to remember that revenue adequacy is not the only constraint governing the reasonableness of rates. A captive coal shipper can have its rates reduced if it can prove that the rate it is paying provides the carrier serving it more than is required to cover the long run costs (operating costs, capital recovery charges, and a reasonable profit) of an efficient move. No profit making enterprise can continue in business unless it is able to cover all of these costs.

The Coal Rate Guidelines, as adopted in 1985, enhance the ability of the shipper to made this case by clarifying the definition of stand-alone cost to allow a shipper to consider the most efficient system for its needs (e.g. a slurry pipeline for coal) and the revenue contribution of all shippers using that system. In addition, under the new Long-Cannon procedures, the efficiency of the carrier can be challenged, a provision that appears to give the shipper substantial protection against being burdened with the costs of wasteful management practices. In fact, the ICC announced on January 17 that it had ordered a refund to a coal shipper in the first application of its new coal rate guidelines.

Question 6. Please explain why your study found no abuse of railroad coal rates when Arizona Electric Power Cooperative, which was one of the utilities studied, testified before this Subcommittee to having sustained railroad coal rate increases of nearly triple 1977 levels.

Answer. According to data provided by the Arizona Electric Power Cooperative (AEPC) to PPA, the railroad originally quoted a rate of $5.80 per ton in 1973 for 500,000 million tons per year. When AEPC doubled the volume planned to be moved in 1974, the railroad increased the quote to $7.04. According to EEI, the first shipment moved in early 1977, at a rate of $8.64 per ton. In late 1977, the railroad was allowed to increase the rate under the capital incentive rate provision of the 4-R Act, which covered movements that required significant rail investments. In subsequent appeals of the capital incentive rate, AEPC argued that the railroad should not be allowed to increase the rate by passing through cost-based increases. As of May, 1984, the rate was $15.25 per ton.

In a non-inflationary world, AEPC rates would appear to have almost tripled since 1974. However, the period between 1974 and 1984 was one where general inflationary increases were substantial. Moreover, railroads experienced higher than average cost increases, in large part due to the increases in fuel prices. If the rates provided by AEPC are adjusted to reflect general inflation (as measured by the GNP deflator), the rate of increase is 2.81 percent per year. If adjustments are made to reflect increases in the index of inflation in rail costs, the rate of increase is -0.70 percent between 1974 and 1984 or a decline, after adjusting for inflation, in the ten years after the original rate was quoted.

The CHAIRMAN. The next witness is supposed to be Martin (Buzz) Fitzpatrick, Jr., Administrator, Office of Transportation, Department of Agriculture. However, I understand he is not in the room at this moment. So, we will hear first from Mr. William Dempsey, president of the Association of American Railroads.

STATEMENT OF WILLIAM H. DEMPSEY, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS, ACCOMPANIED BY THOMAS TIDD, VICE PRESIDENT OF LAW

Mr. DEMPSEY. Mr. Chairman, thank you for having us. I am accompanied by Mr. J. Thomas Tidd, who is vice president of law of the association.

I can easily associate myself with everything that the preceding witnesses have said. It seems to me that they have covered the issues comprehensively and I do not want to duplicate what they have said.

I will just take a few minutes to review what seem to me to be some of the key points.

The rail industry has entered into a period of recovery, as has been said. Last year we had a rate of return of almost 6 percent, which is far below an adequate rate of return, but still the best we have had in some 30 years. This year is not quite as good, but still better than pre-Staggers years.

That has been done, as has been indicated, not by rate increases which have just about paralleled our cost inflation index, but rather by cost reductions of various kinds that are detailed in my statement. That, it seems to me, is one of the great benefits of Staggers. That is to say that we have increased our profitability by productivity improvements, and that I think is what all the shippers want.

Senator Rockefeller seems to think that there might be something regrettable about that, but I cannot think what it would be.

I think the best statement of what has happened to the rail industry was summed up in a Congressional Research Service report recently. They stated that the overall conclusions one might draw seemed to be that the Staggers Act probably helped the railroads during the recession in the years since 1980, but the profit results still are not much better than saving money in an interest-bearing checking account. So we have a considerable way to go, but we are on the right track.

As to some of the specific issues, we have, as the committee knows, made considerable efforts to resolve our differences with the different elements of the shipping community. And in that connection, I am glad to confirm that we yesterday arrived at an agreement with the National Grain & Feed Association with respect to the difficult question of how one goes about disclosing contract information to agricultural shippers. We have issued a press release, together with that association today, and proposed regulations will be in the hands of the Commission next week.

We resolved, as has been indicated, our differences with the National Industrial Traffic League and the Chemical Manufacturers Association with respect to competitive access—the question of what standards the Commission should apply in connection with the canceling of joint rates and through routes and reciprocal switching—and the Commission has adopted regulations which substantially reflect that agreement.

Third, we arrived at an agreement with the American Paper Institute and the National Industrial Traffic League with respect to the market dominance issues. The Commission, as has been noted today, has adopted regulations that substantially incorporate those recommendations.

Now, much will of course depend upon how the Commission puts those new regulations and rules into effect, but I have every confidence that they will administer them in the spirit in which they have been proposed and adopted. And I may say that of course these resolutions do not satisfy all shippers, any more than they satisfy all railroads, but they do represent a substantial consensus of the shippers that were involved and of the railroad community.

That leaves pretty much the utility industry and the coal industry and, to my regret, we have not been able to compose our differences with those interests, though I wish we could.

In that connection, let me simply address before I close, two of the issues that have been discussed here. First, the matter of adequate revenues. It seems to me that the Chairman and Administrator Riley have adequately covered that matter. What we are dealing with here is a standard of earning enough so as to meet the current cost of capital.

To me, it is a self-evident proposition that if an enterprise, over the long run, does not earn the current cost of capital, it is going to go out of business because it simply will be starved of capital. That is self-evident to the utility industry in its own regulatory proceedings, because that is the standard that it invariably calls for and, so far as I can tell, generally gets.

Nor do I think that it should be particularly surprising that no railroad has yet achieved revenue adequacy when one considers the deplorable state that the industry was in just 5 years ago, and when one considers that since then most of our time has been occupied in trying to fight through the deepest recession since the Great Depression of the 1930's.

We do have some major railroads that are approaching revenue adequacy, and of course we hope that they will make it soon.

As to coal rates, the matter again I think has been sufficiently explored. The Department of Energy study found that there were no abuses of monopoly power by railroads in connection with coal rates, and all the figures that are relevant from the Bureau of Labor Statistics are set forth in my statement. The fact of the matter is that in the last 3 years, in real dollar terms, coal rates have gone down. They have gone down in real dollar terms if one measures the trend since 1972 just prior to the OPEC oil crisis. And the short of it is that there has been no skyrocketing of coal rates, no explosion of coal rates, nothing in the coal rate area that would justify, I submit, legislative intervention.

I should finally mention, I think, that I have included in my statement as an appendix an analysis of the relevant Staggers Act issues by some 50 of the Nation's leading economists. And I would invite your attention to that statement. The list of signatories reads like a "Who's Who" of the leading economists in the United States. And on each of these controverted issues, including market dominance, the use of the current cost of capital and the other issues that have been discussed today, including the stand-alone cost principle for adjudicating coal rate cases, the economists stand squarely behind the action that has been taken by the Interstate Commerce Commission.

So it is not as if the stand-alone cost principle is something that has manufactured out of whole cloth. It is a well-established economic principle

Thank you very much, Mr. Chairman.

The **CHAIRMAN**. Senator Pressler.

Senator **PRESSLER**. Thank you, Mr. Dempsey. I know that you represent all of the major railroads in the country and, as such, we look forward to working with them.

I will ask you what I have asked other witnesses today, to take a look for the record at what your recommendations would be for the Rapid City to Pierre line in South Dakota and the Aberdeen to Oaks, North Dakota line, two lines that applied for abandonment and were denied abandonment. We are now struggling to come up with a plan with shippers and carriers or short line operators, or whatever it is going to be, to keep those lines going and keep them profitable.

Mr. **DEMPSEY**. Yes, I will be glad to do that, Senator.

Senator **PRESSLER**. Thank you. I think it will be very useful because they represent sort of the fringe, the most difficult case scenario.

Let me ask you, if necessary for the record, how viable would it be to require or encourage a railroad to sell a branch line at or below salvage value in order to help the short line purchaser overcome any capital investment shortfall?

Mr. **DEMPSEY**. I am not sure that I am familiar enough—in fact I am sure that I am not familiar enough with the principles that are applied in abandonment cases to answer that. I will have to submit a response for the record on that, Senator.

Senator **PRESSLER**. All right, thank you.

As I have mentioned to several of the previous witnesses, I have heard complaints that the railroads often let the lighter density lines wither on the vine by not investing in the physical plant. That is, it becomes sort of a self-fulfilling prophecy as you don't put any capital into it, the shippers stop sending their things, and it gets worse and worse and shippers cannot depend on it, so everybody just gives up.

And a railroad can effectively shut down a line or prepare it for an abandonment proceeding in this manner. What do we need to do legislatively or administratively to prevent that? What standard should there be?

Mr. **DEMPSEY**. Well, as to the character of the problem, Senator, let me make a couple of comments. I don't have any doubt at all that in the days prior to the Staggers Act, and perhaps even in some of the days since the Staggers Act, that there has been an inadequate investment in some branch lines.

That has been due, I think as Mr. Riley said, in large measure to the fact that the railroads simply didn't have enough cash and, as any responsible businessman would, they invested their resources where they had the best opportunity to earn a return.

Now, our cash-flow situation is much better now, so that my assumption is that that problem has been substantially alleviated.

And my second comment is that if a railroad has adequate cash to maintain, to whatever degree it is efficient to maintain, a light density line, the only reason for it not to do so is if the line is not profitable. So it is bad management, it seems to me, not to make that investment if the profitability prospect is there.

I am not saying that railroads never make bad management decisions, but it is bad management. So it should be something that self-interest would police. Now, the Commission indicated that it does consider in abandonment cases whether or not there has been a deliberate and, I take it, an unjustified failure to invest in the line. And I don't know what else to suggest except to encourage the Commission to continue in its exploration of those issues on a case-by-case basis.

Senator **Pressler**. I think one thing that we have found as somewhat lacking in the Interstate Commerce Act is a definition of at what point a carrier either maintains the lines or divests them before they deteriorate. We are going to have to get a definition—maybe we will have to do it legislatively—to determine at what point the divestiture should occur, because the way the State is written, the railroad that wants to abandon a line has an incentive actually to kind of let it die on the vine.

And fortunately the two in South Dakota, abandonment was not allowed. So now I think the railroads have turned around and are working hard to upgrade them and work with various agencies. I think that is something we need to define more.

Mr. **Dempsey**. Let us take a careful look at that problem. I appreciate the point that you make, and see if we have any constructive suggestions to make.

Senator **Pressler**. We would appreciate that for the record.

Next, is the current amount of antitrust immunity adequate to encourage regional spinoffs of light density lines? Is there a need for more immunity in this area, or could you accomplish these spinoffs with less?

Mr. **Dempsey**. I am sorry. I don't know why immunity would be required. I cannot think right off hand what the problem would be.

Senator **Pressler**. It would be spinoffs to short line railroads. Is the current amount of antitrust immunity adequate to encourage regional spinoffs to light density lines?

Mr. **Dempsey**. I just do not see what the antitrust problem is. Why would there be a problem if a large railroad is spinning off part of its system to a smaller railroad? I don't see anything anticompetitive about that. That sounds to me as if it is procompetitive, if anything

Senator **Pressler**. Well, if there are two railroads working together, you could have an anticompetitive situation.

Mr. **Dempsey**. Two trunkline carriers?

Senator **Pressler**. Yes.

Mr. **Dempsey**. Spinning off—I guess I just don't quite understand the factual context.

Senator **Pressler**. A major railroad spinning off to a regional railroad then. In that case there could be.

Mr. **Dempsey**. Well, I certainly have not heard of any problem like that. It seems to me that if the large railroad spins off part of its business to a smaller railroad or to a regional railroad, that ought to serve to enhance competition rather than to repress it.

But obviously somebody has raised a problem. I will simply have to reflect on it but I cannot think of any reason for concern.

Senator **Pressler**. All right.

Are there any restrictions against a class I carrier owning a sizable share of a regional spinoff?

Mr. **Dempsey**. Well, any ownership of that sort would have had to have been approved by the Interstate Commerce Commission if it involved acquisition of control. So if it is a non-control-stock acquisition, then nothing is required, but nothing is violated. If it is a control acquisition, then there is requirement for approval by the Commission.

Senator **Pressler**. What would be your recommendations of changing the ICC's revenue adequacy test to a method that is more like the benchmarks that investors use, or like the methods employed by public utility commissions?

Mr. **Dempsey**. Let me say one thing about regulation by public utility commissions, and it really is in response to something I think Senator Ford said when he suggested that we ought to be regulated like the utilities, and the stand-alone cost test should go in favor of utility type regulation.

I would be delighted with that. If the Congress would pass a bill that would treat us like utilities so that all captive shippers would be required to use railroads, just like all customers in the Pepco service area are required to use Pepco. We would then be guaranteed a rate of return on equity of between 15 and 17 percent, which is where the utilities are, and the captive shippers would then have to pay whatever is necessary to give us that rate of return. The AAR would be the first to endorse that legislation.

Now, as the chairman said, obviously that cannot be done because we operate mainly in a competitive market. As to the adequate revenue standard, it has been suggested—and would be provided in the CURE bill, as you indicate, I think, by your question—that different criteria would be used such as cash flow, debt to equity ratio, market performance and all that sort of thing.

Those were the things that the Commission employed under the old 4-R Act, and they found railroads revenue adequate with rates of return as low as 5 percent. Now, that is a going out of business sale. The only appropriate standard is the one that the Commission has adopted.

The implication is that, if you have different standards, you could have a railroad that does not earn the current cost of capital determined to be revenue adequate. But if a railroad does not earn the current cost of capital, I think it is absolutely indisputable that over the long run it will go out of business. That is what they were doing for 30 years. They were disinvesting, and if anyone wants to see the railroad industry back in that situation, the fastest way to put them there is to change the revenue adequacy test.

So the short of it is, I would favor that.

Senator **Pressler**. Thank you very much.

The **Chairman**. Mr. Dempsey, thank you very much.

[The statement follows:]

Statement of William H. Dempsey, President, Association of American Railroads

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to review with you the railroad industry's experience under the Staggers Rail Act of

1980 ("Staggers"). I will discuss first the impact of Staggers, then examine the principal areas of controversy on which you have requested comment.

THE IMPACT OF STAGGERS

The Pre-Staggers Era.—I will not dwell on the conditions in the railroad industry that, in 1980, presented the Congress with the choice of either unfettering the railroads or nationalizing them. But because the critics of Staggers are now urging a return to the status quo ante, or worse, a brief reminder of the conditions which prompted the Congress to enact Staggers is in order.

First, a few figures: By 1977, some 47,000 miles of track were under speed restrictions because of dangerous conditions. By 1978, there was more than $5.4 billion in deferred track maintenance (excluding Conrail). By 1979, 22 percent of the railroad system was in bankruptcy. During the 1970's the railroad industry's return on investment never reached 3 percent and, in the period 1975 through 1978, was below 2 percent.

While the events of the 70's provided the spur to Congressional action, they were only the culmination of a state of economic decline that began for the railroads at the end of World War I. And, in retrospect the reasons were clear. The advent of a federally funded highway system during World War I presaged the eventual loss of much of the railroads' passenger and freight business, and the explosion in federal investment in the airport, airway, highway and waterway systems following World War II brought the realization. The railroads' share of intercity freight fell from 67 percent in 1946 to 36 percent in 1979. The railroads' share of intercity commercial passenger business declined from about 65 percent in 1946 to less than 5 percent in 1970, when Amtrak was created.

The plain and simple fact was that the development of new modes of transportation and federal investment policies were creating strong competition for the railroads while federal and state regulatory policies were keeping in place a level of railroad service and infrastructure which the marketplace was unwilling to support. The net effect of these policies was to hold rail rates down and rail costs up. The bankruptcies of the 70's provided conclusive evidence that private investors were not willing to underwrite the resulting losses. The choice before the Congress was clear—continue down a regulatory path that could only lead to nationalization or allow economic forces to play a much larger role. It wisely chose the later course.

The Essence of Staggers.—The notion of deregulating the railroads was first expressed in the "4-R" Act of 1976—two of the four "R's" being "regulatory reform." While modest in scope, the Act did recognize that regulation of rail rate ceilings was no longer necessary where competition existed. It also recognized that the regulatory hurdles established for the abondonment process had to be lowered if the railroads were to be relieved of the burdens of uneconomic service. But, by and large, the 4-R Act dealt only with a few pieces of regulatory reform. In the Staggers Act, the Congress went the last mile and put in place a coherent program for ultimately creating an economically rational railroad system. This is reflected in the first three policy pronouncements of the Act: "to allow . . . competition and the demand for services to establish reasonable rates"; "to minimize the need for Federal regulatory control . . ."; "to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues . . .".

The key provisions of the Act give substance to these policies:

The Interstate Commerce Commission ("Commission") is directed to consider a railroad's need for adequate revenues in setting maximum rates;

Rate increases needed to meet cost increases cannot be challenged;

For rates below a prescribed level effective competition is conclusively presumed and their reasonableness cannot be challenged;

Collective ratemaking is, in effect, eliminated;

Contract rates are authorized;

The abandonment process is improved;

The Commission is granted broad exemption powers; and

The states are required to apply federal standards and procedures in regulating intrastate traffic.

Consistent with the policy direction established by the Congress, the Commission has strived to implement the Act through regulations that rest on economically sound underpinnings.

The Effect of Staggers.—Staggers has been a significant factor in the improving financial condition of the railroads. The rates of return on investment have been 3.98, 2.11, 4.29 and 5.71 percent for the years 1981-84, respectively. While these rates of return are 1-2 percentage points higher than those experienced during the

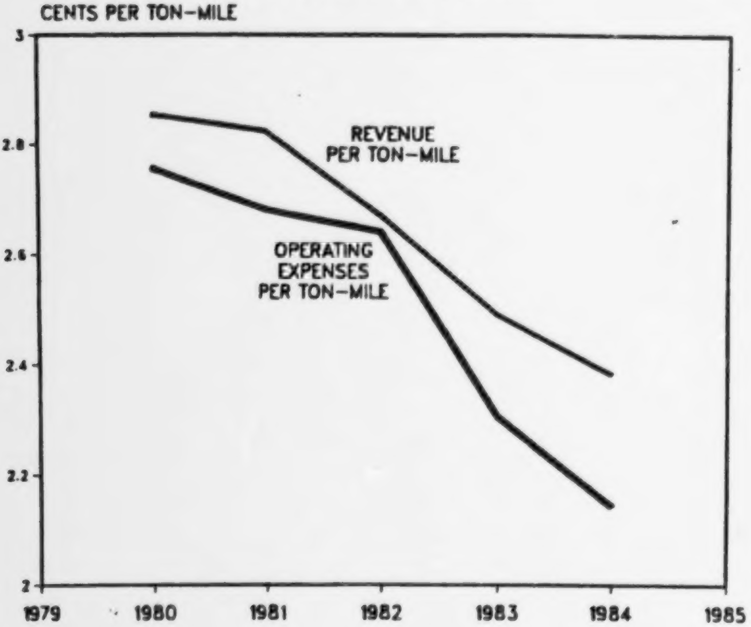
70's and were achieved in a less than robust economy, they remain far below the industry's cost of capital.

The effect of Staggers from the financial standpoint is well-summed up in a Congressional Research Service Report dated May 8, 1985 (No. 85-110E): The overall conclusions one might draw . . . seem to be that the Staggers Act probably helped railroads during the recessions in the United States since 1980, but the profit results still are not much better than saving money in an interest-bearing checking account.

Of most importance is the fact that these modest increases in earnings have come principally from cost control measures rather than from rate increases. In real terms (adjusting for inflation), rail rates on the whole increased less than 1 percent in the four-year period following enactment of Staggers. As the graph on the following page shows, on a ton-mile basis (which better reflects the transportation service provided) rail revenue actually declined in real terms—going from 2.9¢ in 1980 to 2.4¢ in 1984. On the cost side, fortunately, operating expenses per ton-mile were brought down even more, going from 2.8¢ in 1980 to 2.1¢ in 1984.[1]

These cost savings have been achieved in a variety of ways. For example, between 1980 and 1984: The average freight train load has increased 17 percent; Freight train-miles per train-hour have increased 18 percent; Ton-miles per gallon of fuel consumed have increased 17 percent; Ton-miles per employee have increased 38 percent; Ton-miles per mile of road have increased 9 percent.

REVENUE AND OPERATING EXPENSES PER TON–MILE IN CONSTANT DOLLARS



With the improvement in earnings and continued abandonment of uneconomic segments, deferred maintenance is no longer a problem. Capital expenditures on roadway and structures since 1980 total almost $8 billion. And $3.5 billion has been invested in equipment. Because of these substantial investments—aided by the increased cash flow resulting from changes in the tax laws—the rail plant today is in far better shape than it was a decade ago. And this improvement has come during a period in which we witnessed the deepest recession since the 1930's—a recession that in prior years would have taken many railroads into bankruptcy.

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[1] These data indicate that competition has forced the railroads to pass on to the shipper most of the gains in productivity.

While doubtless other factors were at work, the improvements in the physical and financial condition of the railroad system in the post-Staggers period have to be attributed in large measure to the managerial and marketing incentives provided by Staggers. While the railroads still have a long way to go, Staggers has put them on the right track.

The Principal Areas of Controversy.—The arguments being advanced by those seeking to revise Staggers are filled with phrases such as "abuse of monopoly powers" and "ever-increasing rate demands." Since data such as the foregoing and data that will follow belie those arguments, what is the real issue? When the surface arguments are swept aside, it comes down to this: Are the full costs of rail service going to be paid by the users of rail service? Stated another way: Is the nation to continue on the course of attempting to regulate the railroads in an economically rational manner? I would urge that the principal areas of controversy be considered with that issue in mind.

The Adequate Revenue Standard.—The 4-R Act of 1976 directed the Commission to promulgate standards and procedures for determining adequate revenue levels for the railroads. The standards adopted by the Commission in 1978 included a variety of tests, the application of which permitted it to find in 1978 that 13 railroads had achieved adequate revenue levels. These "revenue adequate" railroads were earning rates of return on investment as low as 4 percent.

The Staggers Act directed the Commission to initiate a new proceeding to determine adequate revenue levels. In that proceeding (Ex Parte No. 393), a voluminous record was developed. There were 34 filings comprising over 1500 pages of comments. Submitted with the comments were the statements of 21 experts including professors of economics and finance from our leading universities, economic consultants, transportation consultants, management consultants, finance consultants, investment bankers and public accountants. There was one filing on behalf of the railroad industry, 13 filings on behalf of the electric utilities, 11 filings by major industry groups representing some 3,000 corporations, 2 filings by federal departments, and 3 by state agencies. On this record, the Commission concluded that revenue adequacy should be determined on the basis of a single standard—a rate of return on investment equal to the current cost of capital.

The principal critics of this standard are the electric utilities. In testimony before this Subcommittee two years ago, the witness appearing in behalf of the Edison Electric Institute stated that: A fundamental error . . . has been the Commission's adoption of a completely unrealistic definition of railroad revenue adequacy . . . That is, a railroad would not be deemed revenue adequate unless it were earning a rate of return equal to its costs of capital.

The standard the utilities condemn for railroads is the standard they insist be applied to themselves. To document the hypocrisy in the utilities' position, the AAR undertook to examine in depth the utilities' arguments before their own regulatory bodies. Our study is attached hereto.[2] (Attachment 1) The following quotation of statements made by utility representatives when addressing their own need for revenue are taken from that study:

The rates charged for electric power must . . . provide a fair, reasonably competitive return to shareholders, who make new investments possible. (Chairman of the Board, Edison Electric Institute)

[T]he regulatory body's charter should be to approve rates of return equal to what could be earned in a free market, and the means for the utility to earn such a return. (Chairman of the Board, American Electric Power Company)

The cost of capital is not what theorists or regulators believe it should be, or what they would like it to be, but what the capital markets say it is . . . . [T]herefore, capital must be given the opportunity to earn a rate of return commensurate with the supply and demand forces at work in the marketplace. (A witness for American Electric Power Company)

The utilities carry these arguments further and assert that a failure to permit earnings equal to the cost of capital is not just unfair to their investors, it is confiscatory! (See, Part I, pp. 4–5 of Attachment 1).

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[2] The attachments submitted have been retained in the Committee files.

The utilities' arguments in their own behalf are economically sound. If any firm is to stay in business over the long run, it must be allowed to earn its cost of capital. The utilities' attempts to distinguish the railroads from themselves and all other industries in this regard are as wrong as they are self-serving.

The correctness of the Commission's revenue adequacy standard has recently been affirmed by a group of 56 eminent economists including two Nobel Laureates, two chairman and two former members of the Council of Economic Advisers, a past President of the American Economic Association, and holders of numerous other distinguished positions. In a statement issued last February which examined some of the key arguments being made in opposition to Staggers and its implementation by the Commission, these economists stated that the "appropriate standard for determining the adequacy of railroad revenues is a rate of return equal to the current cost of capital." The economists' statement (hereafter "Economists") is attached (Attachment 2).

In arguing for a variety of financial tests rather than the single cost of capital standard, the utilities are seeking short-term gains for themselves—in the form of lower taxes—at the risk of long-term losses to the nation at large through disinvestment in the railroad system. They rationalize their position by arguing that current stock prices and the diversification efforts of some railroads are proof that a railroad can be revenue adequate notwithstanding the fact it is not earning a rate of return equal to the current cost of capital. The fallacies in these arguments, which were put forth at some length in papers prepared by the Consumer Federation of America—a member of C.U.R.E.—have been concisely described by Theodore E. Keeler, Professor of Economics at the University of California, in two separate comments. In the first (Attachment 3), he deals with the stock price argument:

> A third place in which I disagree with the CFA report on rail financial viability is in their interpretation of the financial markets' valuation of rail securities. . . .
>
> These [*Value Line*] projections (and, importantly, the stock market values of companies) are likely based on expectations of a continuation of the current regulatory environment. If the current proposals [the C.U.R.E. proposals] are enacted, it is difficult to see how projections of earnings (and corresponding stock values) could go up. To the contrary, they would probably fall, and in that case the ranking of the railroad industry would also fall to below average. Thus, the financial markets could very easily be saying that it is only under the current regulatory environment (with current trends in regulatory policies projected into the future) that major rail firms could hope to earn an opportunity cost of capital (by opportunity cost of capital, I mean the return on investment earnable by investors in other industries with equivalent risks. If railroads fail to earn an opportunity cost of capital, they will have difficulty attracting the capital they need to survive).

In the second (Attachment 4), he comments on the diversification argument:

> In its earlier paper on the financial condition of the railroad industry, the CFA took the fact that many railroads are investing in non-rail subsidiaries as evidence that railroads are earning execessive profits. The point of my comments on the CFA report was that there is no connection between a firm's profit level and its tendency to spin off assets into subsidiaries in different lines of business: the decision to do so could as easily occur when a firm has too low a profit level as it could if a firm were earning a normal or excessive level. I took the case of the Penn Central as the most extreme case of a firm earning an inadequate return spinning off its assets in such a way. If in fact a firm could spin off assets when earning an inadequate, adequate, or excessive return, it follows that such behavior is totally irrelevant to the question as to whether the firm is earning an excessive return.

To sum it up, the Commission's adequate revenue standard is consistent with the objective of the Staggers Act, supported by a record that has withstood judicial review all the way to the Supreme Court,[3] blessed by the nation's leading economists, and opposed principally by an industry which demands that the same standard be applied to it.

The Market Dominance Standard.—The concept of market dominance was introduced in the 4-R Act of 1976. The Act withdrew the Commission's jurisdiction over the maximum reasonableness of rates except where it found the railroad to have market dominance. The term was defined as "the absence of effective competition." In implementing the Act, the Commission issued regulations containing a number of presumptions, the cumulative effect of which was to find the railroads market dominant in most cases. The effect of the regulation proved to be directly contrary to a study by a consultant to the Commission which found that 85 percent or more of rail traffic was subject to effective competition.

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[3] *Cert. denied*, 103 S.CT. 2463 (1983).

In Staggers the Congress created a statutory threshold for Commission jurisdiction based on a revenue-to-variable cost ratio set initiallly at 160 percent but escalating over a four-year period to a maximum of 180 percent. With the enactment of this provision, the Commission proposed revising its market dominance standards, which had included, as one of the presumptions of market dominance, a revenue/cost ratio of 160 percent or more. In its final rule, the Commission discarded its presumptions and issued guidelines for determining market dominance based on a consideration of all of the competitive circumstances surrounding the move, including the existence of geographic or product competition.[4]

The Commission's decision was appealed on the ground that the statute did not permit consideration of product or geographic competition. The courts upheld the Commission's interpretation of the statute and the reasonableness of its regulation. In upholding the Commission, the Court of Appeals (5th Circuit) states: "Nothing in the 4R Act requires the ICC to make its decisions in a regulatory vacuum ignoring the practical effects of indirect [product or geographic] competition. Undoubtedly, if the ICC was required to ignore the effects of indirect competition, certain rates would become subject to regulatory intervention even though the rate is governed by market forces. (719 F.2d 722 at 779)"

While the railroads firmly believed the Commission's rule to be correct, they also recognized that some shippers had concerns which warranted consideration and compromise if possible. Under the auspices of the Commission proceeding Ex Parte No. 446, which was instituted to permit railroads and shippers to explore means of reconciling differences arising under Staggers, the railroads began discussions of the market dominance issue with the American Paper Institute (API) and the National Industrial Transportation League (NITL). Out of those discussions came an agreement to petition the Commission for the following revisions to its market dominance guidelines:

1. The burden of proving the existence of effective geographic or product competition would be borne by the railroad rather than the shipper.
2. The criteria for determining whether geographic or product competition provides effective competition would be broadened and clarified.
3. The fact that a railroad faces geographic or product competition with respect to a receiver would not, in and of itself, establish the existence of effective geographic or product competition vis-a-vis a producer; and the fact that a railroad faces geographic or product competition vis-a-vis a producer would not, in and of itself, establish the existence of effective geographic or product competition vis-a-vis a receiver. In any individual rate case, a railroad seeking to establish that receiver alternatives effectively restrain railroads vis-a-vis producers, or that producer alternatives effectively restrian railroads vis-a-vis receivers, would bear the burden of proof as to that issue.

The Commission issued a notice of proposed rulemaking incorporating these revisions last April. After reviewing comments it has voted to adopt the revisions with some technical amendments. Its written decision should be issued shortly.

With the adoption of these changes, there remain no legitimate issues with respect to market dominance. It is beyond dispute that geographic and product competition exist. The shippers' principal argument against the use of geographic and product competition has been the difficulty in their carrying the burden of proving its ineffectiveness. With the change being adopted by the commission, the railroads will now bear the burden of proving that product or geographic competition not only exists but that it is of such force as to constrain effectively the rate being charged by the railroad.

The Coal Rate Guidelines.—The dispute with respect to the coal rate guidelines which the commission has been considering for several years, and which it recently adopted, presents even more starkly than the dispute over the adequate revenue standard the issue of whether the railroads are to be regulated in an economically rational manner.

The economic issues involved are simple and straightforward. If any business is to survive in the long run, its revenues must cover its costs, including the current cost of the capital invested in the business. If the investor cannot earn the cost of capital, he will transfer his capital to some other business.

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[4] Geographic competition stems from the ability of a receiver to obtain the same product from another source. Product competition stems from the ability of a shipper or receiver to substitute a product for the one covered by the rail rate in question.

Unlike electric utilities, the railroads have not been given a monopoly franchise with which, on the basis of an average cost pricing system, they can be assured revenues equal to their costs. To the contrary, the railroads are essentially in the same position as all other businesses in the competitive sector. At most, federal regulation holds out to them only the opportunity to obtain revenues that cover their costs. There are no guarantees.

The efficient use of resources requires that services be provided at the least cost. If the railroads cannot provide the least cost service, they should not be used and, given the pervasiveness of competition, they will not be used.[5] The task for the railroad manager is to determine how to provide and price his services so as to maximize net revenue. As in all businesses, the demand for rail services varies. Some shippers would not miss the railroads if they vanished tomorrow. Others might suffer mild short run problems. Some would suffer severe long run problems. Faced with a wide spectrum of demand the rail manager must differentially price his services as competitive forces permit.[6]

The Commission's task is to decide what ought to be the ceiling on the rates charged the less competitive or so-called "captive" traffic. In making that determination, the Commission must start with one statutory "given:"

> In determining whether a rate established by a rail carrier is reasonable . . . the Commission shall recognize the policy of this title that rail carriers shall earn adequate revenues. . . ." (49 U.S.C. § 10701a(b)(3)).

To that statutory mandate is added the statutory qualification that "adequate revenues" be no more than those necessary "under honest, economical, and efficient management." (49 U.S.C. § 10704(a)(2)).

To these two express statutory provisions, there is added the element of fairness and efficiency in the use of resources. One rail shipper should not be required to bear the costs of any facilities or services from which it derives no benefit.

After several unsuccessful attempts to prescribe arbitrary tests of rate reasonableness for coal, the Commission proposed in 1983, and has now adopted, the only economically rational test—the so-called "stand-alone" test. The coal and utility interests have attacked this test on the ground that it would require, in effect, that each shipper be charged the cost of building its own railroad. That is nonsense.

The stand-alone test rests on the truism that someone has to pay for the rail service which the shippers believe is necessary and on the principle that that "someone" should be the shippers who use the service. Because there are economies of density in railroading, the more shippers a railroad serves the better, as long as each additional shipper is charged no less than the marginal cost of the service it uses. To take advantage of these economies, under the stand-alone test the captive shipper is free to define the rail service it requires in conjunction with any group of shippers it selects. The stand-alone cost is the cost attributable to a railroad of the size selected less the revenue derived from all other shippers using the defined railroad.

Because of the contribution from other shippers, the captive shipper would never be put in the position of paying in effect for building its own railroad except where it was the sole shipper over that railroad. In that circumstance, it should pay the full cost. The construction of single purpose railroads serving utilities is not unheard of. The March 11, 1985 issue of *Traffic World* contained an article by an officer of Western Fuels, Inc., in which he states:

> Plains Electric Generation and Transmission Cooperative, Inc., Western Fuels Association's New Mexico member, is the owner and operator of the Plains Escalante generating station. Plains has signed a long term coal contract with Western Fuels to purchase coal from a mine located 30 miles from its new power plant. Prior to making long-term commitments to the coal resource, Western Fuels studied various transportation options to cover the short haul to the plant. It looked at which common carrier could provide the requisite service, and whether conveyors, trucks or a "captive" railroad could be used. We settled on the "captive" railroad. Western Fuels supplies the plant's fuel requirements at a price tied directly, by contract, to

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[5] This point invites a discussion, which I will forego in this hearing, of the reasons why all modes of transportation should be required to bear the full costs of the facilities they use and thereby avoid the competitive disadvantages created by hidden subsidies such as unrecompensed governmental investment in transportation facilities.

[6] The reasons why this is so are explained at length in Attachment 5 to this statement. Suffice it here to note that if all shippers were charged a rate equal to the railroads' average cost of service, most competitive traffic would be lost because it could move more cheaply by another mode of transportation and the resulting revenue loss would have to be made up by the shippers most dependent on rail service. So, in the long run, under average cost pricing the truly captive shippers would be the only ones left using the rail service and those shippers would be required to bear all of the railroads' remaining costs.

the cost of the service. The private, single-purpose railway, owned by Western Fuels, is obviously far removed from the whims of a deregulation-minded ICC or Congress.

In this case the cost of building a railroad was found to be less costly than locating the plant at the mine site and less costly than alternative modes. The utilities see nothing outrageous about paying stand-alone costs in that context and the principle is identical where existing rail facilities are being used. They are required to pay no more than they would pay if a new competitor to the railroad were to enter the market and provide them with the least cost alternative service.

In the coal rate guidelines which the Commission recently adopted it has attempted to meet some of the more legitimate concerns expressed by critics of the proposed rule. First, the final regulations make clear that a railroad that is revenue adequate over time cannot raise the rates of a captive shipper. Equally important, they reemphasize that "a rate may be unreasonable even if the carrier is far short of revenue adequacy." Thus, while a carrier's revenue adequacy places a cap on the rates it may charge a captive shipper (beyond simply keeping pace with inflation), a carrier's lack of revenue adequacy cannot be used to justify a rate that is otherwise defective. The Commission's decision should put to rest the erroneous, but often-repeated, allegation by advocates of reregulation that the Commission will find no rate unreasonable as long as a carrier revenue inadequate.

Second, the Commission responded to complaints by some captive shippers that they are forced to subsidize inefficiency. It ruled that captive shippers cannot be required to cover any portion of a railroad's revenue adequacy shortfall (the difference between revenues required to generate a return equal to the cost of capital and a railroad's actual revenues) that is attributable to traffic or facilities that fail to cover their directly variable costs. Under the modified guidelines, the amount by which a railroad's traffic or facilities fail to cover their directly variable costs will be deducted on a dollar-for-dollar basis from the revenue adequacy shortfall that captive shippers might otherwise be expected to cover. Any demonstrated operating inefficiencies likewise will be deducted. This provision guarantees that no railroad will be compensated for inefficiencies, or realize a windfall through prices that cover the renewal of equipment or facilities that will not be replaced. The bottom line is that the rates paid by captive shippers will be held to the absolute minimum needed for an "honest, economical and efficient" railroad to earn a return sufficient to renew that portion of its equipment and facilities that can cover at least its long run marginal costs, after charging competitive traffic all that that traffic will bear.

Third, the Commission made clear that stand-alone costs may be represented by the costs of any transportation alternative, including the costs of a coal slurry pipeline. This will assure that the stand-alone cost represents the minimum rate an economically efficient competitor would have to charge to earn an adequate return on its investment. The Commission's approach guarantees that no captive shipper will be required to pay for services from which it derives no benefit, or to pay more than the rate efficient competition would dictate for its traffic.

Finally, the Commission's rules do away with the controversial "inflation plus 15 percent formulation" for rate increases contained in its proposed rule which had, justifiably, distressed many shippers. This formulation was universally criticized, and the railroads were among the most vocal critics. In response to this criticism, the regulations adopted by the Commission require review of every rate increase it approves to determine whether the new rate would cause significant economic dislocations that could be mitigated by requiring that it be phased in. This regulation insures that, in those instances in which rates on captive traffic are proposed to be raised by more than the rate of inflation, the timing as well as the reasonableness of the increase will be considered.

The Economists' views as to the correct standard for the reasonableness of rates coincide with those of the Commission. I refer you again to Attachment 2. They state:

"In setting 'reasonable rates', which we take to mean rates that encourage the efficient use of resources not only of the railroads and their customers but also of the entire economy, the following principles should apply:

'Where marginal cost pricing produces total revenues that are less than total cost, some form of pricing that reflects the responsiveness of demand to price (Ramsey-like pricing) is economically efficient and, where returns are below the market cost of capital, is essential for railroad financial viability.

' Rate prescriptions based on fully allocated cost or other ratios of rate to cost are, in such circumstances, arbitrary and inefficient.

"Defined as the cost a rail carrier would currently have to incur to furnish a particular service or group of services in isolation, 'stand-alone' costs provide, in principle, an objective standard for setting the maximum price a railroad, whose revenues are inadequate, should be permitted to charge in markets where competition is not effective."

You will not hear from the coal and utility interests any economically sound alternative to the Commission's coal rate guidelines. What you will hear is the assertion that there, and elsewhere, the Commission's sin is that it has not "balanced" the needs of the shipper with those of the railroads as the Congress "directed" it to do in Staggers. That argument deserves careful scrutiny.

It rests on a provision in section 3 of the Staggers Act, the "Goals" section. After stating that the purpose of the Act "is to provide for the restoration, maintenance and improvement of the physical facilities and financial stability of the rail system," the section lists five further goals: 1. to assist the railroads in rehabilitating the railroad system; 2. to reform regulatory policy in order to create a healthy railroad system; 3. to assist the railroads "to remain viable in the private sector;" 4. "to provide a regulatory process that balances the needs of carriers, shippers, and the public;" and 5. to assist in rehabilitating and financing the rail system.

Thus, four of the five goals of Staggers involve the creation of an economically viable railroad system. It is in that context that the regulatory process is to "balance" the needs of carriers, shippers and the public. When one looks behind the actions the coal and utility interests are urging upon the Congress which are supposedly designed to "balance" their needs with the carriers needs, it is clear that "balancing" is a euphemism for "subsidizing" and that the needs of neither the carriers nor the public are anywhere to be seen:

They want a revenue adequacy test that will not yield railroad investors a rate of return equal to the cost of capital (which the Economists state is wrong).

They want a market dominance provision that does not take full account of competitive forces (which the Economists state is wrong).

They want a rate reasonableness standard based on a fully allocated cost concept (which the Economists state is wrong).

They want to cut the link which Staggers created between the reasonableness of a rate and a railroad's need for revenue (which is to say that a railroad does not need adequate revenue).

They want to strike the provisions of Staggers that recognize the need for differential pricing (which the Economists state is wrong).

They want to compel the establishment of joint rates and reciprocal switching charges at levels that ignore competitive factors (which the Economists state is wrong).

They want to severely limit the authority of the Commission to exempt railroads from regulation (which means that even where there is an absence of market power railroads should be regulated).

They want to make the abandonment process more restrictive (which flies directly in the face of their charge that the railroads are slow to abandon uneconomic property and thereby reduce the investment base).

And, finally, they want to restore to the states the authority to hold intrastate rates below the level of interstate rates (which in the pre-Staggers years cost the railroads billions of dollars in lost revenue).

In sum, the coal and utility interests' legislative proposal to correct the alleged imbalance in the implemenation of Staggers is a transparent effort to once again receive a subsidy from rail investors through going-out-of-business rail rates. Plainly, the expectations built up over 90-odd years of regulation are not easily altered.

We come back to the realization embodied in Staggers—someone has to pay for the railroad services the shippers say they need. The Congress cannot heed the self-serving pleas of the coal and utility interests without, at the same time, addressing that issue.[7]

Coal Rates. The facts indicate that there have seldom if ever been special interest pleas more deserving of rejection than those being made by the coal and utility interests. The electric utility industry has for several years now been proclaiming that "skyrocketing" rail coal rates are driving up the cost of electricity. The fequency with which that allegation is made is inversely proportional to the evidence supporting it. In the report appended as Atachment 1, the AAR looked very closely at the causes of the massive increases in electric utility rates. Not at all to our surprise we found that the increases had a lot to do with electric utility profits and very little to do with rail coal rates. The following quotation from page 7 of Part II of the report sums up the matter quite nicely:

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[7] I must confess to some puzzlement as to why the electricity consumers of this nation (1) were able to pay for an eight-fold increase in the price of oil and a near four-fold increase in the price of coal between 1972 and 1981; (2) have paid for a $7 billion increase in earnings to utility investors between 1981 and 1984; and (3) are being asked by the utilities to pay for billions of dollars of investment in nuclear power plants which will never become operational, but (4) the requirement that they pay the cost of maintaining the rail transportation system the utilities say they need brings busloads of coal and utility lobbyists to Capitol Hill seeking reregulation of the railroads. If their concern really is for the consumer of electricity, they have obviously picked the wrong case.

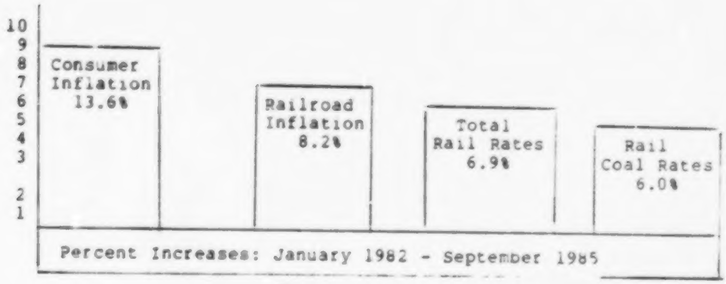
> While [electric utility] fuel costs relative to revenue fell from their 1981 peak, they did increase in absolute terms—costs in 1984 being $842 million (or 2.3 percent) higher than in 1981. Some of that increase was due to increases in the delivered price of coal and other fuels. (See Table 1.) But, in the case of coal, the increased cost is due for the most part to increased consumption. As shown in Table 7, the utilities consumed 67 million tons of coal in 1984 than in 1981—an increase of 11 percent.
>
> But the crucial fact to note is this—while fuel costs were increasing by $842 million between 1981 and 1984, the utility industry's total revenues were increasing by $24.4 billion! Thus, only 3 percent of the increase in revenue went to pay increased fuel costs. Where did the rest go? More than $7 billion of it—or 29 percent—went to utility investors in the form of increased dividends ($4.1 billion) or increased retained earnings ($2.9 billion). All told, the contribution to investors rose from $12.7 billion to $19.7 billion.

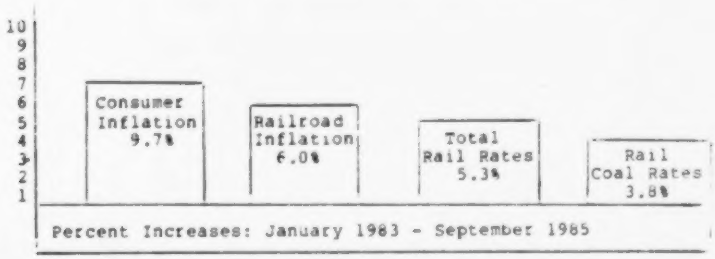
With respect to the principal complaint of the coal interests, it is clear from an examination of the data that rail coal rates are not, as they allege, the principal deterrent to the competitiveness of coal. Looking first at what has happened to coal prices and rail coal rates from 1972, the year preceding the OPEC oil crisis, through 1984, one finds that average U.S. mine-mouth coal prices jumped from $7.66 to $27 per ton, a run-up of 252 percent. In the same period rail coal rates increased substantially less—213 percent—and six percentage points less than the railroads' inflation rate so that in inflation adjusted terms rail rates actually declined. As one would expect, given these differences in the rates of increase, the rail share of the delivered price of coal was less in 1984 than in 1972.

If the measure of revenue per ton-mile is used—which takes account of the fact that each tone of coal was carried on average over 50 percent further in 1984 than in 1972—the contrast between coal prices and rail rates is even greater. On a ton-mile basis rail coal rates in current dollars rose form 1.20 cents in 1972 to 2.43 cents in 1983 (latest data available)—an increase of 103 percent compared with a rail inflation rate of 208 percent and a coal price increase of 239 percent.

In terms of the more recent post-Staggers Act period, the Coal Rate Index published by the U.S. Department of Labor's Bureau of Labor Statistics (BLS), shows that railroad coal rates increased by 27.2 percent from October 1, 1980 (the date of enactment of Staggers) through September, 1985. That increase only slightly exceeds the 25.5 percent increase in railroad rates for all commodities, the 24.5 percent increase in railroad inflation and the 26.7 percent increase in consumer inflation—all between October 1, 1980 and September, 1985. The reported increase in railroad coal rates equates to an annual average increase of 4.9 percent since the Staggers Act.

And as experience under the Staggers Act accumulates, the record respecting coal rates becomes even more impressive. Allowing slightly more than a year for post-Staggers regulatory, marketing and pricing adjustments, the chart below shows that since January 1982, railroad coal rates have increased in total by only 6.0 percent, as compared with a 13.6 percent increase in consumer inflation, an 8.2 percent increase in railroad inflation and a 6.9 percent increase in total railroad rates.





From January 1983 to date, the record is even better: railroad coal rates increased by only 3.8 percent, compared with increases of 9.7 percent in consumer inflation, 5.3 percent in total railroad rates and 6.0 percent in railroad inflation.

Apart from the pace of coal rate increases, are these rates in any event excessive? By no means. In terms of revenue per ton, coal yielded $12.29 in 1984 as compared with $20.88 for all other traffic. In revenue per ton-mile, coal ranks dead last among the major commodity groups. While providing 23 percent of rail revenue, coal constituted 40 percent of the traffic. No more than 20 percent of coal moves at rates high enough to meet the revenue-to-variable cost threshold for ICC rate regulation. There is enclosed a report prepared by the AAR entitled "Statistics Related to Railroad Coal Traffic" which contains much additional information relative to coal rates. (Attachment 6).

Further—and compelling—evidence that the railroads have not abused the rate-making freedom accorded by the Staggers Act is provided by the very limited use made by the railroads of their authority under Staggers to raise rates as much as 6 percent per year (reduced to 4 percent beginning October, 1983) over the inflation rate without suspension or investigation by the I.C.C. Increases actually taken under that authority amounted to .46 percent in 1981, 1.41 percent in 1982, 0 percent in 1983 and 0 percent in 1984.

In short, there is nothing to support the oft-heard charges of "skyrocketing" rates or "abuse of rate-making freedoms." And this is the conclusion reached by every objective examiner of the facts. Thus, in its recently issued draft study on rail coal rates the Department of Energy states:

> The study found no evidence that railroads have imposed 'abusive' rates on coal since 1980; average rail rates have increased less than 0.5 percent per year in real terms since then. . . . . Admittedly, national statistics mask countervailing regional trends; some coal-hauling rates have decreased while others have increased. Yet, even in cases where rates have risen, the increases do not appear to have been widespread or of great magnitude.

In a report last year to the Environmental Protection Agency, ICF Incorporated, a Washington consulting firm, reached the same conclusion:

"Railroad ratemaking gained considerable flexibility under the 4-R Act of 1976 and gained momentum with the passage of the Staggers Rail Act in 1980. As the railroads have moved further into a deregulated environment, there have been in-

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creasing opportunities to observe railroads pricing behavior relative to the conceptual arguments presented earlier.

Although many rail movements have shown substantial changes (both up and down), there is little evidence to suggest that deregulation is leading to widespread increases in rail rates above the underlying costs."

With respect to the export coal market, it is quite evident that the cost of rail transportation has little if anything to do with the foreign demand for coal. This point is discussed at length in Attachment 7 and here I will only highlight the salient facts:

DOE has found that the delivered price of South African coal in Europe and Asia is less than the delivered price of coal from a deep mine in Appalachia even with the U.S. rail and port charges reduced to zero.

It found the same to be true of Australian coal delivered to Asia.

The dramatic increase in the value of the dollar since 1980 has increased the price of U.S. coal in Japan by 5% and relative declines in Australian and South African currencies have decreased the price of their coal in Japan by 19 and 43 percent, respectively.

In the European market, the U.S. dollar doubled in value relative to the Italian lira and the French franc, while the South African rand appreciated by only 10 percent.

Increased competition from foreign coal producers, combined with reduced demand and lower oil prices, has created a very soft coal market.

It is these factors which have dampened the U.S. export coal market. They overwhelm the effect any conceivable reductions in rail coal rates might have on the demand for U.S. coal.

To sum it up, the coal rate issue is a non-issue. The coal markets are very competitive. If the railroads had the monopoly powers the coal and utility intrests attribute to them, why has not the "4 percent" provision of Staggers been invoked to raise rates? Quite simply, it is because the railroads do not want to lose traffic. The Chessie System, for example, had a rate of return on investment in 1984 of only 4.4 percent. Coal constitutes 70 percent of Chessie's traffic.[8] If it has monopoly power, why hasn't it raised its coal rates and increased its earnings to yield a 10-15 percent return? I submit that the answer is because, like other competitive businesses, it wants to keep its customers.

Contract Rates.—The contract rate provision of Staggers has proved to be one of the keys to the limited success of the railroads in the post-Staggers period. Since October 1980, the railroads and their shippers have entered into more than 30,000 contracts. Today, it is estimated that 59 percent of domestic coal, 86 percent of export coal, and 57 percent of all grain moves under contract.

By and large, there has been strong shipper support for the contract provision and its implementation by the Commission. There has been serious disagreement over the degree of disclosure of agricultural contracts. Hopefully, that issue has been put to rest by the agreement announced this week between the National Grain and Feed Association and the Association of American Railroads. I have a copy of the press release which I will submit for the record. In brief, the two parties agree to petition the Commission to promptly promulgate regulations which will: Clarify the specificity with which certain contract information must be set forth in the public summary of the contract; provide for voluntary disclosure of more detailed information by a railroad to a shipper who, based on information available in the public summary, believes it is affected by the contract; and permit filing petitions for discovery where attempts to achieve voluntary disclosure fail.

As you may know, several railroads were opposed to expanding the publication of contract terms as were many in the agricultural community. We were able to find, however, a middle ground that a majority of the memberships of both associations could support. I think it is fair and workable and hope that the Commission will agree.

Competitive Access.—As in the case of the market dominance issue, we were able to work out an agreement covering competitive access issues with shipper representatives (NITL and Chemical Manufacturers Association) in the Ex Parte No. 445 proceeding. (See Attachment 8.) That agreement, which the Commission has now adopted, contains the following features:

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[8] Given the oft-repeated argument that coal shippers are being gouged by the railroads, it is interesting to note that only 48 percent of the Chessie's revenue comes from coal traffic.

1. With respect to the cancellation of through routes or joint rates, the railroad is to provide 45 days' notice and an explanation and justification to any affected party requesting it.

2. Before bringing an action challenging a cancellation, any affected party must seek to resolve the dispute through negotiation with the cancelling carrier.

3. The Commission must suspend for investigation when it determines that the affected party has or would utilize the route or rate for a significant amount of traffic and that the cancellation would eliminate effective railroad competition.

4. The Commission shall not permit the cancellation if, after investigation, it finds it contrary to the competition policies of the Staggers Act or otherwise anticompetitive. In making these findings it may consider intermodal competition, it may not consider product competition, and the existence of geographic competition must be shown by clear and convincing evidence.

5. In situations where a through route, rate, or reciprocal switching does not exist, the Commission shall prescribe the same on complaint of a party if it determines that the route, rate, or switching has or would be utilized for a significant amount of traffic, and that prescription is necessary to remedy or prevent an act that is contrary to the competition policies of Staggers or is otherwise anticompetitive. The limitations stated above with respect to product and geographic competition also apply to prescriptions.

6. The Commission's determinations with respect to the competitive effects of cancellations or prescriptions shall not be given res judicata or collateral estoppel effect in litigation involving the same facts or controversy arising under the antitrust laws.

As with most compromises, this agreement will not satisfy all shippers or all railroads. It does meet, however, the basic concern expressed by many shippers that they were not able to obtain redress for joint rate cancellations. If a shipper or carrier can show that it is affected and that the cancellation eliminates effective railroad competition, the Commission must suspend and investigate the cancellation. And the shipper or carrier cannot be taken by surprise. It is given 45 days' notice and can obtain an explanation of how it will be affected and the justification for the cancellation. With that basic protection, a shipper or carrier can be assured that a grievance will be heard.

As you know, some railroads (the RAM group) opposed the agreement. Those railroads were seeking more easily applied criteria for determining anticompetitive effects (based on revenue-to-cost ratios) and a determination of the anticompetitive effects of cancellations based only on the existence or not of competition among railroads. A large majority of the Association's Board members opposed the RAM proposals because they felt that prohibiting a carrier from cancelling a route or joint rate unless the revenue-to-variable-cost ratio was lower than that realized over any competing route or rate of that carrier could only lead to equalization of rates over all routes. That was one of the banes of regulation and collective ratemaking which the Staggers Act sought to eliminate.

RAM's proposal to limit competitive considerations to intra-rail competition was opposed because it would compel the Commission to ignore the fact that the railroads face strong inter-modal competition in virtually every market.

In short, the expedition to be obtained by the criteria RAM proposed was offset by the likelihood that the application of those criteria would lead to economically unsound results.

In adopting the AAR-NITL-CMA agreement the Commission voted not to include in its regulation provisions regarding the prescription of trackage rights. The railroads concur in that decision. The grant of trackage rights has not been a significant issue among carriers or between carriers and shippers. Until it is, and until the Commission has an opportunity to develop its own thinking through cases arising in the post-Staggers environment, we believe an effort to develop general rules for granting trackage rights or for determining compensation for those rights is premature.

The trackage rights issue has gained notoriety because of the efforts of some groups to avoid a frontal attack on the Staggers Act. Instead, they have proposed amendments to the antitrust laws that have nothing to do with anticompetitive conduct but are designed to make the track of every railroad a public right-of-way available at bargain-basement prices. Should such legislation emerge from the Judiciary Committee I would urge that this Subcommittee carefully examine it.

Boxcar Deregulation.—On May 22, 1981, Conrail petitioned the Interstate Commerce Commission to grant an exemption from regulation under 49 U.S.C. § 10505 for all transportation it provides in boxcars. The exemption was to embrace all regulated aspects of a movement, including rates, divisions, car hire and car service. In a decision issued on May 2, 1983 the Commission expanded the scope of the exemption to include boxcar traffic on all railroads. The Commission also adopted certain changes with respect to the boxcar car hire and car service rules.

Some railroads supported the exemption, others did not. Opponents urged the Commission to pursue exemption on a commodity-by-commodity basis. Some of those opponents feared higher overall rail rates resulting from free use of proportional rates, as well as the cancellation of joint rates generally. The shipping community was also split on the exemption.

In setting forth the rationale for its decision, the Commission stated:

Rate regulation is arguably necessary to prevent abuse of market power only if market forces would permit railroads to increase rates on the service to unreasonably high levels without experiencing a severe loss of traffic. After careful consideration of the present record, we conclude that railroads could not successfully maintain unreasonably high rates on any commodity transported by boxcar.

The decision was appealed and on June 27, 1984, the U.S. Court of Appeals for the D.C. Circuit remanded the Commission's decision (1) with respect to car hire and car service on the ground that the decision was a regulation and not an exemption, and (2) with respect to joint rates on the ground that the Commission failed to adequately consider whether large railroads could exert monopoly power to "close" routes to participation by small railroads or deny small railroads a fair division of revenues.

The Commission reopened the proceeding last June (Ex Parte No. 346 (Sub-No. 8)) and is now considering the comments that have been filed by the parties. The AAR is not a party to the proceeding and has not taken a position on the matter. A substantial majority of the railroad industry represented on the AAR Board of Directors does, however, now fully support deregulation of boxcar traffic moving under joint rates. It is their view that, based on the experience gained during the period the full exemption of boxcar traffic was in effect, that abuses of pricing freedom are highly unlikely because of the competitiveness of the traffic. Because the traffic is highly competitive, they also believe there is a strong incentive to keep all efficient routes open and to arrive at divisions of revenues which keep the carriers involved in the market.

In addition to the proceeding to consider the deregulation of boxcar traffic, the Commission instituted a separate proceeding to reconsider the question of boxcar car hire and car service (Ex Parte No. 334 (Sub-No. 19)).[9] Groups of railroads have filed various proposals in this proceeding. Some railroads support the national car hire system with some modification. Others support establishment of a single car hire charge subject to a "supplemental" use charge imposed by the owner on the user of the car.

The issue of car hire on other than boxcars is also under review by the Commission in Ex Parte No. 334 (Sub-No. 6). In that proceeding the Commission has proposed a comprehensive review of car hire, except car hire as it relates to boxcars. The Commission's notice requests comments on possible improvements to the present car hire system as well as on more market-oriented approaches. Several railroads are attempting to reach agreement on the appropriate response to the Commission's notice.

It seems clear that the present car hire system for both boxcars and other car types has very little support among railroads. The issue is not the need for change but, rather the extent of change that the car hire system should undergo. A significant number of railroads believe that car hire charges are too high and too static and that the "price" of rail cars, like other prices, should vary with demand. Others maintain that the car hire formula must retain some incentive to encourage adequate purchases of new cars and that the compensation levels must be high enough to cover car ownership costs.

There are no simple solutions to the car hire issue because of the varying interests of the car owners and users. Hopefully, the Commission will find an optimal way to reconcile those interests.

That completes my discussion of the issues, Mr. Chairman. I would like to close my testimony by embracing the concluding views expressed in the attached Economist's statement:

In summary, we believe the Staggers Rail Act of 1980 to have been a substantial step toward rationalizing transportation policy and that continued pursuit of the principles stated above would serve the interests of the public at large.

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[9] "Car hire" is the term used to describe the rates railroads charge for the use of each other's cars. "Car service" relates to the responsibilities governing use of the car.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR LONG AND THE ANSWERS

Question 1. Would you care to respond to Congressman Tauzin's remarks about your letter to the House Fossil and Synthetic Fuels Subcommittee regarding captive shipper victories?

Answer. One of the principal charges made by the coal and utility interests has been that shippers cannot get a hearing at the ICC because of the market dominance standards and, even when they do, they do not win. This change underpins two of the amendments proposed in the C.U.R.E. bill which Congressman Tauzin is sponsoring in pursuing the C.U.R.E. argument at a hearing before the House Fossil and Synthetic Fuels Subcommittee, Congressman Tauzin asked me whether the ICC had ordered a rate reduced since passage of the Staggers Act. I told him that I would supply that information for the record, which I did in an enclosure to a letter to the Subcommittee Chairman of October 16, 1985. (See Enclosure No. 1.) You will note that, between the passage of Staggers and that date, there were 79 decisions rendered by the Commission, a Division of the Commission, one of its employee review boards or administrative law judges. The railroads were found to be market dominant in 59 of the 79. Twelve of 49 cases involving the issue of rate reasonableness (excluding recyclables cases) were decided in favor of the shipper. Focusing only on cases decided by the entire Commission, railroads were found to possess market dominance in 11 cases, and in three of those eleven cases the rate was found to be unreasonable.

A record showing that the railroads were found to be market dominant 75 percent of the time and that, in the cases reaching the merits, the rates were found unreasonable 25 percent of the time hardly supports the charge that shippers "can't get a hearing" or "can't win" at the ICC. Faced with those facts, Congressman Tauzin has shifted the focus to the three coal cases decided at the Commission level and now argues that those cases do not prove that a shipper can win at the ICC because two of the three cases were decided on "outdated" market dominance and rate reasonableness standards and the third case involved a contract issue.

A complete analysis of the 3 cases to which Congressman Tauzin referred is appended (See Enclosure No. 2). That analysis shows that his characterization of the cases is inaccurate in several respects. Here, however, I want to stress the irrelevance of his characterization to the principal charge repeatedly made by the coal and utility interests which prompted his query to me, viz., that the shippers "can't get a hearing" and "can't win" at the ICC. That is the issue and as to that issue I stand by my response of October 16. The shippers' complaints have been heard in a large majority of the cases and they have prevailed in a significant number of the cases heard.

Question 2. Are captive shippers going to begin to win some cases at the ICC now that the Commission has issued its Coal Rate Guidelines?

Answer. I do not agree with the question's obvious implication because, as Enclosure #1 shows, shippers have been winning cases at the ICC. But the question contains a more subtle implication which also warrants discussion—the implication that something is wrong if the shippers do not win some of the cases at the ICC.

Most of the maximum rate cases pending at the ICC arose under section 229 of the Staggers Act. That section provided a 180-day "window" in which shippers could file complaints that any rate existing on October 1, 1980 was unreasonable. Any such rate not challenged in that period could not thereafter be challenged. Given that opportunity, 864 cases were filed. It is, of course, possible that absent the Staggers Act some of the rates complained of would have been challenged at some point by a shipper. But the fact is those rates had been in effect prior to Staggers and had not been challenged. Given that fact, there is no compelling reason to expect the shippers should win cases brought simply because of the "last chance" offered by section 229. If the rate had been perceived by the shipper to be unreasonably high it would have been challenged before October 1, 1980; and, if the shipper did not so perceive it, why should the ICC be expected to on review?

The disposition of the cases brought under section 229 buttresses my view that the overwhelming majority of the rates in question were not being hotly contested. Of the 864 cases filed, the ICC reports that 822 have been dismissed due, for the most part, to negotiated settlements. Of the remaining 42, at least 21 are expected to be settled. Of the remaining 21, 15 are being held in abeyance at the request of the complainant, 5 are intrastate in character, and 1 is in the record building stage.

Only 12 of the 21 involve steam coal movements. Whether any of those 12 deserves to be won by the shipper under the Coal Rate Guidelines remains to be seen.

Question 3. Does the AAR support the application of the Coal Rate Guidelines to other commodities?

Answer. The AAR believes that the economic principles which underpin the Coal Rate Guidelines are sound and that the application of those principles in determining reasonable maximum rate levels for other commodities would be appropriate. (As I noted in my prepared testimony, a statement by an eminent group of economists endorsed differential pricing and the stand-alone cost test for determining the reasonableness of rail rates.)

I cannot say at this time what changes, if any, should be made in the guidelines to account for facts and circumstances which might be developed by the ICC to distinguish other commodities from coal and thereby warrant variations in treatment, albeit not in the underlying economic principles.

Question. 4. Do you agree with Mr. Ronald Young's testimony before the House Fossil and Synthetic Fuels Subcommittee that the Coal Rate Guidelines methodologies are too expensive for a small shipper to prosecute a rate case before the ICC? How should a small shipper proceed to show the ICC that a railroad rate is unreasonably high?

Answer. The Coal Rate Guidelines were developed to cover the typical coal rate case. The typical coal rate case does not involve a "small" shipper. That is, in fact, true of most commodities. None of the 864 cases filed under section 229, for example, involved a small shipper.

One of the major coal-carrying eastern railroads advises me that its shipments of coal are distributed approximately as follows: 60 percent to electric utilities, 16 percent to export markets, 12 percent to steel companies for coking, and 12 percent to industrial users. The first 3 shipper categories, comprising 88 percent of the total, are plainly not "small." While the remaining 12 percent involves relatively small shipments—30,000 to 200,000 tons annually—the shipper involved is not necessarily "small" (auto manufacturers and chemical companies for example).

So, the first point to be noted it that the small shipper problem, if any, is a small problem. The second point is that I would fully expect the ICC to use its discretion to cut the cloth to fit the case in the event of a complaint from a small shipper which alleges that a rate is too high but that it does not have the means for, or that the amount in dispute is not worth, a standalone cost analysis.

Questions. 5. It is the AAR's position that there have been no unreasonably high railroad rates since Staggers?

Answer. Whether any rate is unreasonably high can only be determined in a proceeding before the ICC. And, as to that, the record speaks for itself as I have indicated in response to Question 1. It is AAR's position that the likelihood that unreasonably high rates have been imposed since Staggers is very low simply because rate increases under Staggers have been extremely modest. On the average, rail rate increases since Staggers have exceeded railroad cost increases by only 1 percent. Another indicator of the fact that rail rate increases have been constrained is the limited use of the so-called "revenue enhancement" provision (49 U.S.C. 10707a(c) and (d)). As stated in my testimony, coal rate increases taken under authority amounted to only .46 percent in 1981, 1.41 percent in 1982, and 0 percent in 1983 and 1984.

Question 6. The Norfolk Southern has been telling Congress that it should sell Conrail to the Norfolk Southern because Conrail cannot stand alone and needs a healthy parent to sustain it through difficult times. The Norfolk Southern has cut its debt nearly in half since Staggers, bought North American Van Lines for over $300 million in cash, bought a controlling stake in Piedmont Aviation, bought other diversified investments, accumulated about a billion dollars in cash, and has maintained excellent bond ratings. Transportation Secretary Dole tells us that Norfolk Southern is a "very profitable company." The company's annual report says that nearly 90 percent of the holding company's pre-tax income comes from the Norfolk & Western and the Southern Railroads. That's one side. On the other side, though, the ICC says those two railroads are grossly revenue inadequate, and thus need to charge their captive shippers even more. Who is correct, the DOT or the ICC?

Answer. The Norfolk Southern is admittedly a "profitable" company (although I am informed that it does not have a billion dollars in cash and does not control Piedmont Aviation). Compared to most other railroads, it is "very profitable" company. But "profitable" or "very profitable" is not, and should not be the test of revenue adequacy. Any company realizing net income in a given year is "profitable" from an accounting standpoint. That company can even be realizing substantial net income—and thus be "very profitable" from an accounting standpoint—but still not be earning its cost of capital, which is the test of revenue adequacy and the test of profitability in economic terms. Even though very profitable from an accounting standpoint, if a company fails over the long run to earn its cost of capital, eventually it is going to go out of business. (In fact, in its effort to acquire Conrail Norfolk Southern has taken the position that it is seeking a better return within the railroad industry in the hope of avoiding withdrawing assets from the industry.) In the period 1960-1980, for example, the railroad industry was "profitable" every single year, but 18 percent of it—as measured by the decline in miles of track—went out of business. Similarly, various individual railroads were generally profitable for many years, but their level of profitability became so low they sank into bankruptcy. One of the principal objectives of the Congress in enacting Staggers was to reverse that trend.

If allowed to function, the marketplace will ultimately decide how much investment in rail facilities and equipment this nation needs. It will do that by allowing the rail investor to earn the current cost of capital on the needed investment. A shipper who claims to be "captive" to a railroad is claiming that it must have the service that railroad provides. That service will continue to be provided only if the railroad investor can earn the current cost of capital on the investment required to provide the service. (The stand-alone cost test assures that the shipper does not pay more than the investor requires.)

In 1984, the Norfolk Southern's rate of return on investment was only 6.1 percent whereas its cost of capital as determined by the ICC was 15.8 percent. If one were to suppose that all Norfolk Southern shippers were captive shippers, it is clear beyond any doubt that, if that inadequate rate of return were to continue, in the long-run the service those captive shippers require would cease to be available. That would occur because the Norfolk Southern, not earning a return on its investment equal to its cost of capital, would be obligated to its stockholders to convert assets earning inadequate returns to more profitable uses.

As to the question of whether the ICC of DOT is correct, the answer is that both are because there is no necessary relationship between the fact of a company's profitability, its cash position and its acquisitions and whether its earnings on existing assets are adequate. The United States Steel Corporation was not a notably profitable company when it made a multi-billion dollar acquisition of Marathon Oil. Indeed, the acquisition was prompted by the inadequate returns obtainable by U.S. Steel and others in the steel business. The Penn Central railroad pursued acquisitions virtually up to the date of bankruptcy as the principal way to avoid that fate.

On the point which the question raises of revenue inadequate railroads needing to charge captive shippers more than they are now charging them, I would like to make two points: The first is that revenue inadequacy does not create any license for a railroad to charge captive shippers "even more." In adopting the Coal Rate Guidelines, the ICC emphasized that "a rate may be [found to be] unreasonable even if a carrier is far short of revenue adequacy."

The second point is that, contrary to that statement by the ICC in the Guidelines, the electric utilities demand the right to charge their captive customers as much as necessary to enable the utility investor to earn the current cost of capital on its investment. Let us look at PEPCO as a case in point:

For the period 1980-84 PEPCO's earnings increased from $88.8 million in 1980 to $152.3 million in 1984. Earnings per share went from $2.10 to $3.23.

PEPCO's annual dividends increased from $61.8 million in 1980 to $91.5 million in 1984. Accumulated retained earnings in that period increased from $206.3 million to $358.8 million.

The average return on equity in the electric utility industry in 1980 was 11.4 percent. So, with a 12.2 percent return, PEPCO was a very profitable company. But, being very profitable did not dissuade PEPCO from seeking to impose higher rates on its captive customers:

In 1980, PEPCO asked for a $98.2 million rate increase and was granted $54 million;

In 1981, it asked for $37.1 million and was granted $35.4 million;

In 1982, it asked for $187.2 million and was granted $67.8 million;

In 1983, it asked for $85.6 million and was granted $25.6 million;

In 1984, it asked for $80.1 million and was granted $29.9 million.

As part of the last rate hike, PEPCO was told not to come back for more before 1986 so, notwithstanding a very high profit level, another rate increase may surface shortly.

I have not examined the records in PEPCO's rate hike proceedings; but I can state with utter confidence that PEPCO justified each increase on the basis that it was needed to provide adequate returns to its investors. And, as the record shows, they certainly succeeded. By no measure was PEPCO "grossly revenue inadequate" but it maintained, and each year its regulators agreed, that it had a "need to charge [its captive customers] even more."

It is far past the time for the electric utilities to stop seeking to deny to the railroads the fruits of private enterprise which they claim for themselves.

Question 7. You and the railroads are fond of pointing out that the railroad industry was either bankrupt or facing severe economic stress in 1979 when we were considering the Staggers Rail Act. What railroads do you include in that category? The Burlington Northern? The Norfolk & Western? The Southern? The Chessie System Railroads? The Southern Pacific?

Answer. I include all of the railroads mentioned, although two of the five were, financially, among the strongest in the railroad industry. During the 1970s, 22 percent of the industry was in bankruptcy and, in 1979, the industry's rate of return on investment was only 2.93 percent. Even against that dismal industry backdrop, several of the railroads mentioned do not sparkle. The B&O and C&O (now the Chessie System) earned rates of return of 4.45 and 4.59 percent, respectively; the BN earned 4.11 percent; and the SP earned only 1.55 percent. The Norfolk and Western and Southern earned, for railroads, more respectable rates of return in 1979—8.93 percent and 9.10 percent, respectively. These figures are to be compared with the railroads' cost of capital in 1979 of 11.7 percent.

It is to be noted that the electric utility industry which, because of lower risk, has a lower cost of capital than the railroad industry, earned a rate of return on investment of 8.5 percent in 1979—an average rate of return almost three times that earned by the railroad industry.

Question 8. If the Staggers Act has worked as well as you say it has, then why are all the railroads still so grossly revenue inadequate? When will any of these major railroads attain revenue adequacy?

Answer. The Staggers Act has worked well but it has not worked miracles. In the decade prior to enactment of the Staggers Act, the railroad industry's return on net investment fluctuated between 1.2 percent and 2.93 percent. The Eastern District railroads had aggregate losses in seven of those years, including every year between 1975 and 1979, and never had a return higher than 0.46 percent during the decade. The aggregate return for Southern District carriers fluctuated between 3.98 and 5.62 percent during the period, and exceeded 5 percent in just three of those years. Western District carriers' aggregate return fluctuated between 2.65 and 4.38 percent.

Given this background, it is hardly surprising that the railroads are not earning their full cost of capital just five years after the enactment of the Staggers Act. The railroads are, however, doing better as a result of the Act. None of the railroad industry is in bankruptcy, despite the very sharp economic downturn in the early 1980s. In 1984, the railroad industry earned a return of 5.71 percent, while the Eastern, Southern and Western District carriers earned returns of 6.36, 5.76 and 5.34 percent, respectively.

Competition has severely constrained the railroads' ability to increase rates—as evidenced by frequent "hold-downs" even where inflation-based increases are authorized. Without the regulatory freedoms permitted by Staggers, the railroads could not have cut costs and tailored rates and services as they did to cope with the deep recession of 1981-82. That is the measure of Staggers' success—from both the shippers' and the railroads' viewpoints. The most the railroad industry can ask from the Staggers Act is the opportunity to become revenue adequate. As I indicated in my response to Question 6, if allowed to function, the marketplace will ultimately determine whether any railroad becomes revenue adequate. The challenge is to maintain Staggers' emphasis on marketplace solutions and, where regulation is necessary, regulatory policies that best substitute for marketplace solutions.

Question 9. The AAR and the ICC continue to insist that every major railroad is revenue inadequate. You and the ICC say that competitive traffic can't get the railroads to revenue adequacy, because the railroads have to meet the competition's price and so the captive shipper has to pay the bill. Please explain how the captive shippers are ever going to get any real relief from high railroad rates so long as the Commission says the railroads need more money still than they are getting from captive traffic.

Answer. The question prompts two observations. First, it appears to be premised on the belief that captive shippers are now paying more than they should pay for rail service. There is little if any credible evidence supporting that premise. Second, in its Coal Rate Guidelines, the ICC has not said that captive shippers have to pay whatever is required to make the railroads revenue adequate—and that is certainly not the position of the AAR. What the ICC has said in promulgating the Guidelines—and the AAR agrees—is that a captive shipper is not being overcharged if the rate complained of does not exceed stand-alone cost (the cost at which an efficient competitor could provide the service or group of services) and the railroad meets the various tests of efficiency.

But the facts are that the railroads face stiff competition and that very little traffic is truly captive even in the short-run (in the long-run perhaps none of it is). So even with the captive traffic, rates cannot be raised significantly without the likelihood of the traffic being lost.

In my view, the only way the railroad industry can hope to achieve revenue adequacy is through continuation of the enlightened regulatory policies reflected in Staggers. By that I mean they have to be allowed to continue to tailor facilities, services and rates to the demands of the marketplace to the fullest extent possible, recognizing the need for continued regulation as necessary to protect shippers from abuses of market power. But "abuses of market power" cannot be construed—as coal and electric utility interests propose—to mean subsidizing the transportation of coal at the expense of the railroad investor and, ultimately, the public.

Question 10. Mr. Dempsey, Alfred Kahn, who as you know is a firm believer in deregulation, said in a speech last fall that "[m]any railroads are evidently earning the cost of capital on their incremental investments, and are therefore able to attract the additional capital they require." Do you agree?

Answer. I understand that Alfred Kahn is generally reputed to be a firm believer in deregulation. He is also, however, a frequent expert witness for the electric utility interests. The statement quoted in the question was, in fact, taken from a verified statement he filed in behalf of the electric utilities in the Coal Rate Guidelines proceeding. Certainly, in that proceeding, Dr. Kahn was not appearing as a "firm believer in deregulation."

With respect to the merits of the quote from Dr. Kahn's testimony, I am advised that he offered no evidence to demonstrate either that the railroads were earning the cost of capital on their incremental investments or that they were able to attract all of the capital the market would support in the absence of regulation. But assuming, for the sake of argument, that his suppositions were correct, it would tell us nothing about how railroad earnings should be regulated unless we also inquired into how earnings on sunk capital were regulated—and, given his writings discussed below, Dr. Kahn should agree.

As the railroads point out in the proceeding from which Dr. Kahn's quote was taken, today's incremental investment is tomorrow's sunk investment. An investor is not going to provide capital for an incremental investment that promises an adequate return if, once made, he cannot continue to earn that return. A railroad's rate basis is nothing more than an aggregation of incremental investments and today's "incremental" investor is tomorrow's "sunk cost" investor. It is a certainty that the many billions of dollars invested in the railroad industry since 1980 would not have been provided but for the investor's expectation that the opportunity for a return promised by Staggers would remain.

On this issue, Dr. Kahn's views have not been entirely consistent. The speech of Dr. Kahn's to which the question refers was given on December 28, 1984. In the same footnote in which the quotation appears Dr. Kahn also makes the following statement which was drawn from his verified statement in the Coal Rate Guidelines proceeding:

"The economist witnesses for the railroads had not given any consideration to the possibility that the aggregate net book investment of the railroads, which the ICC proposed to use as the rate base against which to test the adequacy of total revenues, might contain a large amount of obsolete and/or excessive capacity, the continued operation of which is economically unjustified, and, in particular, that contributes nothing to the carriage of the captive shipper."

This is a recital of the familiar electric utility charge that the railroads are really earning all they need to earn if one considers the fact that they have a lot of obsolete and excess plant which is not "used or useful" and for which the shipper should not have to pay. Of course, all of this allegedly excess plant is never identified by any shipper or association of shippers such as EEI or NCA—becuase, obviously, none of the plant serving their constituents would ever be considered excess. And so it is with every shipper. The fact is, of course, that the railroads have abandoned excess plant as rapidly as the law and politics allow—usually in the face of strong shipper opposition and only after lengthy ICC proceedings.

But even while Dr. Kahn was preparing his speech of December 28, 1984 in which he reaffirmed his adherence to the "used and useful" test as a check on railroad earnings, he was forgetting a speech before the National Conference of State Legislatures which he had delivered only one month earlier on November 29, 1984. There he was engaged in trying ot convince the regulators of electric utilities that the electricity ratepayers, not the utility investors, should pay for unused and useless nuclear plant that is not completed and does not go into service—indeed, they were urged to ". . . repeal the ideotic laws that forbid passing onto consumers any portions of [those] costs. . . ."

Dr. Kahn went on to tell the utilities' regulators that the correct investment base standard for the utilities is not "used and useful" but "prudent when made." The reasons given by Dr. Kahn for this switch are particularly interesting in view of the electric utility industry's abiding assault on the ICC's revenue adequacy standard for railroads. I quote:

"More important and fundamental, such laws violate the implicit bargain between companies and government—representing, respectively, investors and consumers—that lies at the heart of public utility regulation, and without which it can not in the long run function. Under the terms of that bargain, companies are promised the opporttunity to earn a reasonable return—and no more—on all dollars prudently expended. What this means is that when they make successful investments, as electric companies clearly were doing in the 50s and 60s, the lion's share of the benefit will go on to consumers. The other side of that coin must be that when, fulfilling their obligation to serve, the companies make reasonable mistakes—nothing I say should be interpreted as saying they are entitled to make returns on truly imprudent expenditures, or that in no circumstances should a company be permitted to go under—they be given a corresponding opportunity to get it back.

"In short, you can't play a game of heads we win tails you lose with these companies and not pay for it the next time they go out to raise the capital they need to serve your constituents.

"Any reasonable distribution of the burden of these recent catastrophes will inevitably be painful to both ratepayers and stockholders. But the public utility institution has served us well in the past, and—lacking, as I do, any vision or example of a superior alternative—I believe we should not lightly discard it. *That is what we would indeed be doing if we violated the fundamental regulatory bargain by playing a heads we win tails you lose with investors—permitting them only a modest return on the dollars they have invested in projects that turn out to be successful, while allowing them no return of the dollars sunk in plants that are not, as the phrase goes, 'used and useful.'* " (Emphasis supplied.)

Dr. Kahn's remarks compel a couple of observations. First, if there is a "fundamental regulatory bargain" that assures the electric utility investor his return on capital even when the customer is not served by that investment, why does it not apply to rail investors?

Second, it seems that Dr. Kahn, himself, has provided the answer as to why I should not agree with his statement that, since railroads appear to be earning the cost of capital on their incremental investments, they are able to attract the additional capital they require and, therefore, inferentially, do not need increased revenues. As he points out, investors are not in the habit of being twice-bitten. They will not continue to provide funds for incremental investments if subsequently those investments are not allowed the opportunity to earn a current cost of capital.

Question 11. We keep hearing that the railroads are forcing coal producers to make capital improvements at the loading end, by building new tipples and other facilities, and that the utilities are buying all the coal hoppers needed for unit trains. We have also heard many railroads advertise or talk about their productivity improvements, their cost-cutting measures and other savings. Why should we be impressed that, as AAR puts it, railroad rates are only increasing slightly above inflation? Aren't railroad costs going down? In your answer, please focus on your costs of moving coal—the railroads seem to be making the people at both ends pay for the improvements, and yet rates are still going up.

Answer. I am not aware of any instances in which railroads have "forced" shippers to make capital investments. I am aware that some volume tariffs require shippers to meet certain loading and unloading requirements, or to provide equipment, in exchange for lower volume rates. Rather than being "forced" to buy equipment, it is my understanding that shippers often prefer to supply their own equipment for financial or service reasons. And rail tariffs typically offer one rate when railroad-owned equipment is used and a lower rate when shipper-owned equipment is used. Consequently, while a railroad's costs go down when the shipper provides equipment, so does the revenue it receives.

In the prepared statement I presented at the November 1 hearing, I stated that the railroads' increased earnings have come principally from cost control measures rather than rate increases and referred to a chart showing that most of the gains in productivity have been passed on to the shipper. Thus, in constant dollars (adjusting for inflation), against a decrease in expenses per ton-mile of 22.6 percent in the last five years there has been a 17.3 percent decrease in revenue per ton-mile.

To focus on the costs of moving coal, as you request, the only data generally available is that from the ICC's one percent waybill sample comparing revenues to costs by major commodity groups. The data for 1982 (the latest year available) show that the aveage revenue to variable cost ratio for all coal movements was 1.46. That ratio is the same for metallic ores (1.46) and comparable for chemicals (1.44), both of which are also bulk commodities.

Question 12. In this connection of railroad costs, another quote from Alfred Kahn. He said in a speech last December that "if we deflate the BLS [Bureau of Labor Statistics] index of railroad freight rates by the CPI [Consumer Price Index] we find increases of 8.6 percent between 1979 and 1982, and 6.5 percent between 1979 and 1983." Would you care to comment on that, as it seems in conflict with your assertions about where real railroad prices are going?

Answer. I do not know the context in which the quoted statement was made or why Dr. Kahn would deem it appropriate to use the Consumer Price Index to deflate rail rates. In determining the direction of prices in real terms, economists usually use the most relevant deflator available. In the case of railroad prices, the most relevant deflator is not the Consumer Price Index but, rather, the Railroad Cost Adjustment Factor which measures changes in railroad costs specifically.

If Dr. Kahn's point is that railroad costs rose faster than the Consumer Price Index in the late 1970s and early 1980s, that is true. The periods Dr. Kahn cites include periods of rapid inflation in fuel costs and interest costs, which tend to have a greater effect on the railroad industry than on consumer prices generally. Conversely, items such as food and beverage prices—which did not surge like fuel costs—are a significant component of the Consumer Price Index but have virtually no effect on rail costs. It is for these reasons that an index specifically reflecting rail prices is to be preferred over a more general index. To the extent there is any conflict between my assertions and those of Dr. Kahn, it is due to his use of a less relevant index.

Question 13. Are you familiar with the Long-Cannon factors? Whatever happened to them? Has anyone won a case based on them?

Answer. I am familiar with the Long-Cannon factors. Consistent with the dictates of the Staggers Act, they have been incorporated as one of the key constraints in the Coal Rate Guidelines. I am not aware of any case brought under section 229 of the Staggers Act where that issue has been argued and finally decided on the merits. I understand that the issue is present in a number of pending proceedings.

I should add that I would be surprised if a shipper did win a case based on the Long-Cannon factors. No rational railroad manager is knowingly going to price traffic below cost (the first Long-Cannon factor). Nor is he knowingly going to charge shippers less than they are willing to pay (the second factor). As long as a railroad is revenue inadequate there is no incentive whatsoever for such management conduct. The railroad, plain and simply, would be losing profits otherwise available to it. To presume that for-profit firms knowingly ignore profit opportunities, or retain managers who do, flies in the face of experience. Absent the presence of the first two factors, it is hard to see how the third Long-Cannon factor—one commodity bearing an unreasonable share of the revenue burden—could be present.

Question 14. The Coal Rate Guidelines say at page 26 that the Commission "must determine that the rate at issue is unreasonably high as a result of the inefficiencies shown before ordering a rate to be reduced on that basis." How does someone meet that burden? Does that mean that the shipper must show that but for the inefficiencies, the railroad would be revenue adequate before it can get rate relief? The AAR's counsel took that position before the Commission, didn't he? He said, "Only if the costs that the shipper has identified that have been inefficiently incurred account for the entire shortfall from revenue inadequacy or from the stand-alone cost for the group. Otherwise, let's say that I am short 20 and 10 of it is my fault. The shipper is still responsible for the ten." Does the AAR continue to hold to this interpretation?

Answer. The AAR did not participate in the *Coal Rate Guidelines* case and the statement attributed to the AAR's counsel was made by counsel for the eastern railroads. The statement is, however, consistent with my understanding of the basic limits to which the Commission may reduce a carrier's revenue opportunities to compensate for inefficiencies. In other words, a carrier's operating or pricing inefficiencies are to be borne by the carrier and not the shipper: but the shipper must pay the legitimate costs of the service it is receving from the carrier. This approach is fully consistent with the working of competitive markets, which deny inefficient competitors the opportunity to recover inefficient costs, but let them set prices which cover efficient costs.

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I would turn the question around and ask why should a shipper not pay for all costs of the service efficiently provided to him? The shipper can legitimately argue that it should not bear costs of carrier inefficiencies; but that proposition does not lead to the proposition that a shipper should benefit from carrier inefficiencies by paying less than the costs of efficiently provided service. In the quotation from the Coal Rate Guidelines referred to in the question, the ICC was discussing a proposal for a "bounty" approach to railroad cost inefficiencies that apparently had been proposed by the Edison Electric Institute (i.e., "that some form of compensation be furnished to any party who discovers an inefficiency"). I think the ICC was correct in concluding that there has to be some relationship shown between the inefficiency identified and the shipper's rate.

As a general rule, there will be little basis for questioning a carrier's operating efficiency because railroads, like their shippers, have every reason to increase efficiency in order to increase profitability. However, where a shipper challenging a rate believes that a carrier is operating or pricing inefficiently, it can bear its initial burden of proof by pointing out those alleged inefficiencies to the Commission. A carrier, of course, would have an opportunity to rebut any such allegations; but I must note again that if the allegations are correct, it would be in the carrier's interest, as well as the shipper's, to have those inefficiencies eliminated.

Question 15. The third Long-Cannon factor says the Commission is supposed to consider whether one commodity is bearing an unreasonable share of the railroad's revenue burden. How has the Commission implemented that factor, either in the Coal Rate Guidelines or elsewhere?

Answer. The Commission has implemented the third Long-Cannon factor at page 26 of its slip opinion in *Coal Rate Guidelines, Nationwide* (served September 3, 1985). There the Commission states:

"The third Long-Cannon factor requires that we consider, in determining the reasonableness of a rate, whether one commodity is paying an unreasonable share of a carrier's overall revenues. A disproportionate share is not necessarily an 'unreasonable" share. There are at least three ways in which unreasonableness can be demonstrated under CMP [the Commission's constrained market pricing standards]. A party may demonstrate that its rate exceeds the Ramsey optimal rate and/or a SAC rate level. Additionally, it can show that the rate is higher than needed to eliminate otherwise unavoidable revenue need shortfall." (Footnote omitted.)

Question 16. The Platte River Power Authority demonstrated in its case before the ICC that the BN was losing $245 million a year on traffic carried at less than directly variable costs, and another $459 million on traffic that does not recover long-run marginal costs. The Administrative Law Judge said he would disregard that evidence because it only covered one year. How much money money does a shipper have to spend to satisfy his burden of proof?

Answer. The question contains two incurrate assertions. In the case referred to (No. 39687, *Platte River Power Authority v. Burlington Northern Railroad Company,* no printed, served April 19, 1985), the Platte River Power Authority did not demonstrate that BN was losing $245 million a year on traffic carried at less than directly variable cost, and the Judge did not reject the complainant's evidence on that point "because it only covered one year." The Judge rejected the complainant's evidence because the complainant incorrectly defined "directly variable costs," which is the measure of whether traffic is being carried at rates that contribute to going concern value and is, therefore, compensatory. The complainant employed a definition which was at variance with the ICC's definition and which yielded considerably higher costs. So the fact is the complainant lost on that issue because it could *not* demonstrate that BN was carrying any traffic below directly variable costs.

With respect to the assertion that the complainant demonstrated that another $459 million was being lost on traffic that did not cover long-run marginal costs, the Judge did reject that evidence because it only covered one year. The ICC requires multi-year data in this instance because much of the traffic involved is highly competivite and the data for any single year is not representative of revenues or market conditions. Because this was a sufficient reason for rejecting the evidence, the Judge did not need to address the quality of the data presented. It is the BN's view that, had he done so, he would have found it to be wholly inaccurate because it was derived by applying system-wide average costs to specific movements. Such an approach completely ignores the actual circumstances of each movement—the most obvious examples being back-haul movements in which the actual out-of-pocket costs to the carrier are far below average costs.

It appears to me that the lesson of this case is not that inordinate expenditures are required to satisfy the complainant's burden of proof, but that the burden of proof cannot be met by data based on erroneous analyses.

I am advised that Platte River and the BN have reached an agreement in principle on the disputed rates and that a settlement of this case is expected shortly.

Question 17. Isn't the ICC's annual recyclables determination a fair surrogate for a revenue to variable cost percentage that, if charged to all traffic, would allow the railroads to cover all costs, variable and fixed, and earn a reasonable profit? Doesn't the 180 percent revenue to variable cost threshold give the railroads a significant amount of freedom to differentially price their captive traffic above fully allocated costs? Does the C.U.R.E. bill or any other bill pending before this Congress change that?

Answer. The answer to the first question is "yes" provided that "charged to all traffic" means "recovered from all traffic."

The answer to the second question is "no." There is no connection between the 180 percent jurisdictional threshold and the fully allocated cost level used to set the ceiling on recyclable rates. The question assumes that traffic moving at rates above the fully allocated cost level is "captive." By definition and in fact most traffic below the 180 percent threshold is not captive and most rates below that level are constrained by competition.

As to the third question, the C.U.R.E. bill would drastically change the freedom of railroads to price their services differentially. The fact of the matter is that the C.U.R.E. provisions have nothing to do with rational ratemaking—the objective is to create a litigation club which utilities can wield to beat down rail rates:

First, the bill would require in every rate proceeding specific findings as to whether a carrier needs "to have the opportunity to achieve or maintain revenue adequacy." (In other words, it would first question whether a railroad needs to be economically viable!)

Second, it would require findings as to whether a carrier's revenue needs required charging rates above 180 percent of variable cost (thus transforming the Staggers jurisdictional threshold into some sort of rate ceiling and, implicitly, turning every rate proceeding into a revenue adequacy proceeding).

Third, it would require the ICC to make findings as to the relationship of the rate to the cost of service, but forbid the ICC from applying the only economically rational cost standard—the "stand-alone" cost.

Finally, it would require specific findings with respect to the Long-Cannon factors (current law requiring only "consideration" of the factors).

From all of this, I can only conclude that C.U.R.E.'s object is to create a litigation morass in which the ICC becomes buried under a mound of findings—including the very need for the railroad's existence—and the railroad is faced with defending with particularity not only the rate in question, but all of its rates.

An examination of the 1982 waybill data will demonstrate the absurdity of the C.U.R.E. notion that the difference between the fully allocated cost level (currently about 154 percent) and 180 percent is all the differential pricing flexibility the railroads require. In 1982, the fully allocated cost percentage for all commodities carried by the railroads was 127.7. To reach the revenue adequacy level in 1982 (a fully allocated cost level on all traffic of 143.8 percent), the railroads would have had to receive an additional $3.021 billion in revenue. It is ludicrous to assume that somehow, if they but tried, the railroads could have charged enough for the traffic moving at rates below 180 percent of variable cost to have made up for that revenue short-fall.

If, as the C.U.R.E. bill suggests is possible, the revenues on all traffic moving at revenue to variable cost ratios above 180 percent had been reduced to 180 percent, the rail industry would have lost $1.048 billion in revenue in 1982. Does C.U.R.E. have any suggestions as to which traffic moving at rates below the 180 percent level could have taken the rate increases necessary to compensate for the $1.048 billion loss and still been shipped by rail rather than truck or barge? Perhaps the coal shippers—80 percent of whom moved their coal at rates below 180 percent of variable cost in 1982—would volunteer since most of them claim to be captives (even in the face of the railroads' inability to raise their rates to the jurisdictional threshold). My guess would be, however, that when faced with the prospect the number of self-proclaimed captive coal shippers would decline rapidly.

Question 18. Do the railroads agree that there should be an upper limit on the rates they can charge captive shippers? What should that upper limit be? For all commodities?

Answer. Yes, the railroad industry agrees that there should be an upper limit on the rates a railroad can charge a captive shipper. That limit should be the stand-alone cost of the movement. That does *not* mean—as the utilities like to characterize it—that the upper limit on a rate would be "the cost for a shipper to build its own railroad". The stand-alone cost for a shipment is the *minimum* rate that a hypothetical competitor to the railroad defined by the shipper (including a coal slurry pipeline) would have to charge to earn an adequate return on its investment. The hypothetical competitor can serve any group of shippers. Thus stand-alone cost is the surrogate for the rate that would be charged by an efficient competitor if one existed. It gives the shipper the best of both worlds—a competitive rate without the expense and delay that would be required to create the competitor.

The stand-alone cost limitation, together with some additional limitations, are contained in the Coal Rate Guidelines. The railroad industry supports the application of these guidelines for coal rates. With respect to non-coal commodities, see my response to Question 3 above.

QUESTION OF SENATOR PRESSLER AND THE ANSWER

Question. In an effort to preserve service to light density lines in rural states like South Dakota, would the AAR support a policy of allowing a shortline railroad to purchase lines at or below salvage value if the shortline continued to feed traffic to the selling railroad?

Answer. I am aware that several of the Association's member roads have embarked upon programs to provide better service over light density lines in rural states by selling such lines to newly emerging regional railroads and shortlines. The arrangements between the selling road and the new owner vary, but generally are quite beneficial to the new railroad. For example, several of the selling railroads have agreed to provide equipment at or below market rates to meet the needs of the new railroad and to provide favorable rate arrangements for traffic interchanged with it. The AAR believes the purchase price should be a matter determined privately by the buying and selling railroads. The price often reflects the undertakings of each party with respect to commercial relations after the sale, and prescribing a purchase price ceiling would limit the negotiating flexibility needed by the parties to work out the best possible arrangement. Moreover, and even more importantly, compelling a railroad to sell its property at a price below net salvage value would appear on its face to present Constitutional questions.

[Enclosure No. 1]

ICC DECISIONS ON RATE REASONABLENESS

The entire Commission has found market dominance by a railroad in eleven cases. In three of those, the rate was found to be *unreasonable*. The rate was ruled *reasonable* on six occasions (two of which have been affirmed by the Court of Appeals, D.C. Circuit). In one case (No. 37516) the complaint was dismissed at the request of complainant before a decision was made as to rate reasonableness. In the other case (No. 38025S) the market dominance finding was appealed to the courts before the entire Commission considered the rate reasonableness issue. The eleven cases were:

Docket No.	Commodity	Rate	Status
No. 36114(1)	Coal	Reasonable	Aff'd by D.C. Circuit.
No. 37276(1)	do	Unreasonable	Pending on remand.
No. 37409	do	do	Do.
No. 37516	Iron ore		Dismissed per complainant.
No. 38025S	Coal		On appeal to court.
No. 38566	Iron ore	Unreasonable	Do.
No. 38793	Coal	Reasonable	Pending on remand.
No. 38809	do	do	Do.
No. 38946	do	do	Aff'd by D.C. Circuit.
No. 39060	do	do	Pending on remand.
No. 39071	do	do	Final—no appeal.

Out of 79 decisions made by the Commission, a Division of the Commission, one of its employee review boards or administrative law judges, 59 decisions found the railroad to be market dominant. Twelve of 49 decisions on the issue of rate reasonableness (excluding recyclables cases) held the rates in question to be unreasonable.

[Enclosure No. 2]

Supplement to Mr. Dempsey's Response to Question No. 1

The first of the three cases discussed by Congressman Tauzin is No. 37276 (Sub-No. 1), *Coal, Wyoming to Redfield, Arkansas,* 364 I.C.C. 988 (1981). The dispute here involves a rate for the movement of coal from three points in Wyoming to an Arkansas Power & Light Co. generating station near Redfield, Arkansas. In 1979 the ICC, using pre-Staggers rate reasonableness standards, reviewed this rate and found that it was reasonable [No. 36719, Arkansas Power & Light Co. v. Burlington Northern Inc., 361 I.C.C. 504 (1979).] None of the currently sitting Commissioners, of whom Congressman Tauzin is critical, was involved in that decision.

In 1981, the ICC revisited this rate dispute in No. 37276 (Sub-No. 1). While the Commission's current market dominance standards had not yet been adopted, the Commission explicitly considered each of the four elements (intramodal competition, intermodal competition, product competition and geographic competition) that would be considered under the current regulations, and it found the railroad to be market dominant with respect to the involved traffic. The Commission then applied a ton/ton-mile rate methodology which, as Congressman Tauzin points out, is no longer in use, and found the rate unreasonable. Since no evidence was introduced concerning several elements of the Coal Rate Guidelines adopted by the Commission in Ex Parte No. 347 (Sub-No. 1), there is no basis to assume that the rate would, or would not, be found reasonable under current Commission standards.

I would offer several observations concerning this case:

(1) The rate involved was hardly exorbitant, even before it was reduced by the Commission. The assailed rate was 160.9 percent of variable costs, which is well below the current jurisdictional threshold of 180 percent established by Congress and maintained, as Senator Long's question number 17 points out, in the C.U.R.E. legislation. Thus, even though the Commission found the rate unreasonable and ordered it reduced, there should be no dispute even with supporters of the C.U.R.E. legislation that were this case brought today the railroad's rate would be found reasonable as a matter of law.

(2) The ton/ton-mile methodology used by the Commission produced a maximum rate of only 150.2 percent of variable costs. That rate is below the 158.8 percent level set in the ICC's annual recyclables determination which, as Senator Long points out in question number 17, is a fair surrogate for the revenue to variable cost percentage that if charged to all traffic would allow the railroads to earn an adequate return. This vividly illustrates both the regulatory difficulties that led to enactment of the Staggers Act and the reason that the ICC abandoned the ton/ton-mile methodology in favor of the current Coal Rate Guidelines.

(3) The rate relief the ICC was prepared to grant, using the ton/ton-mile methodology, was $1.25 per net ton. However, because of the 160 percent revenue to variable cost threshold enacted by the Congress, it set the new rate at 160 percent of variable costs rather than 150.2 percent and this reduced the rate relief to the 12 cents per net ton criticized by Congressman Tauzin in his testimony before the Committee. Moreover, using the current 180 percent revenue to variable cost threshold set by Congress, and endorsed by supporters of the C.U.R.E. legislation, the assailed rate would not today be considered unreasonable and *no* rate relief would be justified.

(4) The traffic involved today moves under a contract negotiated voluntarily between Arkansas Power & Light and the Chicago & North Western Railroad. Approximately 59 percent of all domestic coal, and 86 percent of all export coal, moves under such contracts.

Thus, far from being an example of monopolistic railroad pricing and inadequate ICC response as characterized by Congressman Tauzin, the *Redfield* case demonstrates that the railroad's rate was very low compared to the jurisdictional threshold even for a shipper that the ICC found to be captive and the ICC's involvement was more unwarranted than inadequate.

Let me now turn to the second of the cases cited by Congressman Tauzin, No. 37409, *Aggregate Volume Rate on Coal, Acco, Utah to Moapa, Nevada,* 364 I.C.C. 678 (1981). The dispute in this case involved an annual volume rate published by the Denver & Rio Grande Western Railroad Co. and the Union Pacific Railroad Company for coal from Acco to a Nevada Power Co. plant at Moapa. I would begin by observing that the record in the case shows that the assailed rate of $9.70 per ton represents a 27 percent reduction from the trainload rate of $13.26 that was in effect prior to its publication, and that the railroads agreed to publish the reduced rate in exchange for an increase in the minimum tender and introduction of an annual volume minimum. I would also note that the record shows that the shipper solicited the rate and agreed to its terms in writing but the Commission, applying its decision in Ex Parte No. 358 (Sub-No. 1) governing contracts entered into prior to enactment of the Staggers Act, did not conclude that the rate was a contract rate.

The ICC determined that the railroads possessed market dominance over the traffic at issue using the (then current) 160 percent revenue to variable cost statutory jurisdictional threshold and market dominance guidelines. As with the *Redfield* case, it explicitly examined each of the four factors that the Commission would examine in making a market dominance finding today.

The Commission considered the reasonableness of the $9.70 per ton rate using the ton/ton-mile method, which is no longer in use. Using that formula, it reduced the rate to $7.88 per ton, which was 180 percent of the variable cost of the move. No evidence was introduced concerning the elements of the Coal Rate Guidelines and so, as in the *Redfield* decision, there is no basis for anyone to conclude that the rate would, or would not, be found reasonable today.

The final case discussed by Congressman Tauzin is No. 38566, Rates on Iron Ore to Escanaba, MI, Chicago and Northwestern, not printed, decided December 21, 1981. In his testimony, Congressman Tauzin told the Committee that ". . . this was not even a rate reasonableness test. This was a case in which the ICC was asked to uphold a contract between the shipper and the railroad, and even when the court upheld the contract, it found one of the rates was too low and raised it. That is a case where the shipper won?" (transcript, p. 48) Let me explain the facts as I understand them.

The case involves three rates for the transportation of iron ore from three mines in the Marquette Range in the Upper Peninsula of Michigan to an ore dock owned by the railroad at Escanaba. The rates were originally published by the Chicago & North Western in 1969, and were periodically updated by the railroad, pursuant to a written agreement with the shipper. In 1981, after a cost study revealed to the railroad that it was not earning a compensatory rate on the traffic and efforts to renegotiate the contract with the shipper failed, the railroad proposed to publish new rates.

After finding that the proposed rates exceeded the (then current) 165 percent revenue to variable cost ratio statutory jurisdictional threshold, the Commission examined the four factors it would consider today and determined that the Chicago & North Western possessed market dominance over the iron ore traffic at issue. The Commission then determined that the rates were contract rates which, as a general matter, the Commission will not disturb. Commenting on the contract rates for the Empire and Tilden mines, which produced revenue to variable cost ratios of 156 percent and 130 percent respectively, the Commission found that while these rates ". . . do not provide windfall profits to the railroad, C&NW recovers more than its variable costs on those routes. We reiterate what we said in (citation omitted) that 'we do not view our role to be one of extricating carrier or shippers from questionable bargains, especially when the circumstances are not compelling.' We see no compelling reasons to extricate C&NW from the two compensatory rates provided in the agreements merely because they are not as high as C&NW would like. The contract rates have not been shown unreasonably low contrary to the public interest." (decision, pp. 19-20)

With respect to the third rate, for the Republic mine, the Commission found that it produced a revenue to variable cost ratio of just 88 percent. Since no evidence was presented that would justify recovery below the railroad's variable cost, such as evidence that the rate involved a backhaul or traffic that would move only until the equipment or plant utilized becomes exhausted, the Commission found that the Republic mine rate would require a cross-subsidy by other shippers contrary to the Staggers Act, including the first of the Long-Cannon factors (49 U.S.C. 10707a(e)(2)(C)(i). The Commission therefore declined to enforce the Republic mine contract rate on the ground that it violated public policy, and directed the railroad to negotiate with the shipper and publish a compensatory rate.

I believe the facts support the proposition that the *Escanaba* case does, contrary to Congressman Tauzin's evaluation, represent a victory for captive shippers. In the case of two of the three rates, the Commission found in favor of the shipper's position that the rates were contractual and thus enforced rates that otherwise would have been well below the statutory jurisdictional threshold, and therefore subject to increase at least to the threshold level. While the Commission required the third rate to be increased, in doing so it was enforcing one of the Long-Cannon factors, which proponents of the C.U.R.E. legislation complain is not enforced, and declined to approve a rate that would have resulted in a cross-subsidy which, presumably, would have been paid by other captive shippers.

The **Chairman**. Next we have Mr. Martin Fitzpatrick, Department of Agriculture.

STATEMENT OF MARTIN FITZPATRICK, JR., ADMINISTRATOR, OFFICE OF TRANSPORTATION, DEPARTMENT OF AGRICULTURE

Mr. **Fitzpatrick**. Thank you, Mr. Chairman, for the opportunity to come before you today. My name is Martin Fitzpatrick. I am Administrator of the Office of Transportation at the Department of Agriculture. I appreciate the opportunity to talk about Staggers. We have some concerns.

I would like to submit my formal remarks for the record to save time for those outside the beltway to testify later.

We in the Department of Agriculture support Staggers, and we do not support any of the legislation that would change Staggers at this time. A few inequities exist for small shippers that are impacting them very negatively. Medium- and large-size shippers have taken advantage of innovative rates and services that railroads have offered.

Captive shippers in areas such as North Dakota, Montana, South Dakota, Wyoming, and in certain areas of other States need protection from excessive rates and market restrictions by carriers.

Commissioner Strenio pointed this out in his testimony that the Commission has not finished its job, and I agree; I think there is still a way to go. We think the Commission can work these problems out.

Since 1980, my office published assessments of rail and motor carrier deregulation. We interviewed 48 elevators in 1983. We conducted nine workshops and hearings in 1983 and 1984. We conducted an extensive study of the impact of deregulation on Kansas wheat movements, and we have conducted a mailout survey of over 2,000 elevators. We conducted a field survey in Michigan, Illinois, Indiana, and Ohio.

In addition, we are almost in daily contact with shippers and trade associations and carriers. So I think we are in a very good position to talk about the impact of deregulation on agriculture.

These comments today will address what we have perceived to be the three main transportation concerns of small grain shippers. First, there is a lack of clearly defined standards for rate reasonableness. Second, the trade restricting nature of route cancellations and the problems with reciprocal switching cancellations or unreasonable increases in switching charges. And third, the inequities of contract secrecy.

First I would like to discuss the reasonableness of rates. The current rate reasonableness standards frustrate small shippers in agriculture. The rules and regulations established by the ICC in practicality eliminated recourse for small shippers. Current rules present significant obstacles for small shippers without large financial and legal resources.

Under present rules, shippers must show market dominance. Under market dominance, the ICC will not examine a protest unless the rate exceeds 180 percent of variable cost. The shipper must then address the evidentiary guidelines requiring extensive evidence related to intermodal and intramodal competition.

Should the carrier claim that geographic and product competition offer restraint for ratesetting, the shipper must prove that it is ineffective. Stricter standards are imposed on revenue adequate carriers, however, not one carrier has been deemed revenue adequate by the ICC, as has been pointed out by several here today.

The Commission handling of rate cases has been discouraging, particularly for those with a legitimate complaint. Numerous large and small shippers attending our workshops expressed their dissatisfaction with vague, burdensome rules promulgated and administered by the ICC.

The adequacy of rate reasonableness standards has not yet been tested. Worldwide recession reduced traffic, causing equipment overages and required carriers to stabilize rates. Upon return to normal economic times with no equipment surplus, protections will become more important.

Rate reasonableness standards must be simplified and made less burdensome for the small agricultural shipper and that is the bottom line from the Department of Agriculture's standpoint.

The second area is competitive access. These concerns center on availability to shippers of services offered by other railroads such as through the establishment and maintenance of joint rates and routes and reciprocal switching agreements.

Cancellation of routes or switching or an unreasonable increase in charges for switching services restrict marketing options for shippers. It has been said that competition is the only regulator in a free market.

Competition must therefore be maintained and even promoted.

Such concerns are particularly valid at this time due to the reduced number of competitors resulting from carrier consolidations. Despite consolidations, many shippers rely on more than one carrier to reach market. Of the 48 elevators we interviewed in 1983, 27 used multiple carrier routings to reach market; 6 of the 48 reported the cancellation of reciprocal switching to be a problem.

The record in Ex parte No. 456 suggests that competitive access problems do indeed exist. Rather than elaborate on the many examples of problems provided in that proceeding, which is in my testimony, I ask that this committee in its review of Ex parte No. 456 give consideration to the statements filed by the Fertilizer Institute, the National Grain & Feed Association, the Chemical Manufacturers Associations, the Indian Grain Group, and Cargill, and the shortline railroads.

Ex parte No. 456 is an example of a recent trend to negotiate solutions to shipper-carrier problems. Most captive shipper problems were left unresolved in that proceeding. Two agreements did come out of the proceeding, however, one addressing the rate reasonableness standards being considered in Ex parte No. 320, and one addressing the competitive access issues being considered in Ex parte No. 445.

My office has submitted written comments on these agreements to the ICC stating that while we support negotiated agreements, the proposed rules do not set specific standards for the ICC to follow in addressing the issues, and are not responsive to the needs of agricultural shippers.

If a resolution to these problems, by negotiation or otherwise, is not made soon, the problems might be with us for some time. We are currently in a period when national attention is focused on regulatory problems. The carriers have yielded very little in this setting. Consequently, the outlook for settlement, particularly a negotiated one, at a later date when problems are local in nature and there is no national interest present, is not promising. I think the carriers have to give more attention to shipper needs and I will talk about that later.

The **Chairman**. Mr. Fitzpatrick, you are over your time. Can you wind it up in just a few seconds?

Mr. **Fitzpatrick**. Yes, sir.

We have made a case study on contracts and the impacts of rail deregulation in Kansas on which I will gladly answer any questions. We would like to mention that Mr. Dempsey of the AAR has made, as he mentioned before, a step in the right direction by negotiating the contract disclosure settlement with the National Grain & Feed. We hope the ICC approves this, and we trust everybody stays with it and tries to work it out.

In conclusion, I just want to say, Mr. Chairman, we do support the Staggers Act and we do not support opening up the Staggers Act at this time. We want to work out these problems.

The **Chairman**. Senator Pressler.

Senator **Pressler**. Could you tell me or submit for the record, how much per bushel of wheat on the average, how much is in transportation before it reaches a port of transport abroad or to a destination where it is milled?

Mr. **Fitzpatrick**. I will supply that information for the record.

Senator **Pressler**. What would you say off the top of your head? Let's say a bushel of wheat or grain in South Dakota that goes to Duluth?

Mr. **Fitzpatrick**. About 25 percent.

Senator **Pressler**. Twenty-five percent of the value of it you mean, or 25 cents per bushel?

Mr. **Fitzpatrick**. Twenty-five percent of the value.

Senator **Pressler**. Twenty-five percent of the value. So probably close to 80, 90 cents a bushel.

Mr. **Fitzpatrick**. At this time, yes.

Senator **Pressler**. Yes, it would be very useful for me to have that, if you could, by truck and by train in two categories: one, a point of exit for export; and two, a point of refining or grinding or whatever to prepare in the food process; because I think that it really will illustrate that about, as you said, between 25 and 30 percent of the cost of grain or the transportation cost is about a quarter of what people are paid, and that really becomes prohibitive.

In your 1984 report on grain marketing, USDA recommended that Congress direct the ICC to develop procedures by which shippers, particularly small grain shippers, could determine unfair discriminatory practices caused by confidentiality of rail contracts.

What type of procedures did USDA have in mind? Does the agreement between the Grain & Feed Association and the Association of American Railroads meet your concerns?

Mr. **Fitzpatrick**. Well, the recent negotiation between National Grain & Feed addressed one issue, the contract disclosure issue and the contract terms. We are very happy with that agreement.

We think that is a good effort in the right direction. The railroad and the National Grain & Feed did not negotiate rate reasonableness and we are not presently happy with the standards at the ICC because they are rather complicated and complex. We hope that the railroads and National Grain & Feed would get back together on that issue.

Senator **Pressler**. Would you submit for the record your recommendations as to what can be done and what steps can be taken on the Rapid City to Pierre line and the Aberdeen to Oakes line.

Mr. **Fitzpatrick**. We will be glad to supply information for the record. We do have, Senator, a SWAT team, if you will, of people who go out and help with branch line abandonment cases. It advises shippers and communities what they can do.

Senator **Pressler**. Well, these have both been ruled not to be abandoned, so we are just beyond that stage.

Mr. **Fitzpatrick**. OK.

Senator **Pressler**. Could you discuss some examples of the steps USDA has taken to prevent the abandonment of light density lines around the country? And you mentioned your SWAT team. But what kind of programs or legislative initiatives would be appropriate to help preserve these light density lines?

Let me say I think that maybe agricultural products are more affected. We have heard a lot about coal here. We have a lot of coal-producing Senators on this committee, but in terms of the crux of the marginal lines, a lot of them are in agricultural areas. What recommendations or legislative initiatives—although you are for the Staggers Act, do you see that are needed?

Mr. **Fitzpatrick**. Well, as I said before, we support no legislation to amend the Staggers Act. Although the Secretary and I recognize that this is a problem, we are doing our part to respond to concerns that are expressed to our office and we have procedures that are given out. In fact, in North Carolina, we have assisted two major shipping groups down there with rural abandonment cases, so we will be glad to help your State.

There is 4,000 miles proposed for abandonment throughout the country right now, and it is of concern to us and in fact in your State, Mr. Chairman, since 1980, 141 miles have been abandoned.

Senator **Pressler**. That is true, but I am mainly aimed right now at the two lines I am most concerned about. They have just ruled they cannot abandon them, so now we have got to take the steps, the postvictory in the ICC, so to speak; 2 cases out of almost 200. Only 2 cases out of 200 proposed abandonments were denied, and we took the cases to the ICC.

But now we are at the next step.

Mr. **Fitzpatrick**. Senator, I respectfully say that in many cases those abandonments are in the best interest of the railroad industry and the shippers. There are cases where we think that there is a sufficient volume to require the railroad to stay in there, but I think we can help if we know about it.

Senator **Pressler**. Good.

Now, what shippers in South Dakota are captive? That may be something you will want to answer for the record after you have looked at it a bit. You defined "captive" in your opening statement.

Mr. **Fitzpatrick**. I would have to spend some time looking at South Dakota.

Senator **Pressler**. If you will spend some time looking at those two lines. I am trying to focus everybody's attention in Washington on those two lines as kind of an example of the problem we face.

Mr. Chairman, I thank you very much.

The **Chairman**. Thank you.

Mr. Fitzpatrick, do you have dealings with the ICC or do people in your office have dealings with it?

Mr. **Fitzpatrick**. Yes. We prepare statements for cases before the ICC and get involved with it.

The **Chairman**. Do you believe that the ICC is sensitive to the problems of small shippers, and sensitive to the problems of the agricultural community?

Mr. **Fitzpatrick**. I believe they have not been in the past. I see some effort to do that. I think the encouragement by the ICC for AAR and National Grain & Feed to work out the contract dispute in rules is a step in the right direction, and I think I would encourage the ICC to continue to look out for small shippers.

We think that protections for small shippers are clearly in the Staggers Act and we would just like to see them applied more frequently.

The **Chairman**. Do you think that the emphasis should be on the interpretation and application of the Staggers Act, but not on changing the underlying law?

Mr. **Fitzpatrick**. That is exactly my point of view.

The **Chairman**. You have not given up on the ICC. You are continuing to hang in there?

Mr. **Fitzpatrick**. I am an optimist and I think we can work with them and I think that they have shown some signs of changing their ways.

The **Chairman**. Thank you, sir.

[The statement follows:]

STATEMENT OF MARTIN F. FITZPATRICK, JR., ADMINISTRATOR, OFFICE OF TRANSPORTATION, DEPARTMENT OF AGRICULTURE

I am here today to testify that the Department supports the Staggers Act and believes that it has been generally beneficial to agriculture. However, a few inequities have developed that are having an adverse effect on the smaller, less financially strong agricultural shippers which traditionally have been protected by rail regulation.

Many madium to large sized grain shippers have taken full advantage of innovative rail rates and services to improve financial returns in the post Staggers period. On the other hand, some smaller elevators that have access to one rail carrier are having difficulty maintaining a competitive position because they have trouble securing transportation alternatives. In areas such as North Dakota, Montana, Wyoming, western South Dakota, and in certain areas of other states, elevator operators have expressed concern that they lack adequate protection from high rates, discriminatory practices, and reductions in competitive access by carriers. This does not mean that the Staggers Act should be changed. The establishment of proper rules by the Interstate Commerce Commission and an interpretation of those rules that gives more consideration to these shippers could solve these problems.

I BACKGROUND

Since 1980, the Office of Transportation, USDA, has been assessing the reactions of agricultural shippers to key provisions of the Staggers Act and to the implementation and administration of the Act by the ICC. We published an initial assessment of motor carrier and rail deregulation in 1982 and a report on the impact of rail deregulation on grain marketing in 1984. In the summer of 1983, our personnel interviewed 48 grain shippers in 11 states. In response to the concerns expressed during these visits and to assist grain shippers in adjusting to the new regulatory environment, we conducted 9 regional workshops across the United States in 1983-84. Over the past year, our Office has been cooperating with Kansas State University on a case study of the impact of rail deregulation on the marketing of Kansas wheat. We have just recently completed a nationwide survey of grain shippers to determine the effect of rail deregulation on grain marketing. Our office is in almost daily contact with grain shippers, grain receivers, trade associations, carriers, and many other groups and individuals which utilize rail transportation.

Although agriculture has generally benefited from changes in transportation after Staggers, I believe it is important to address three main transportation concerns for small grain shippers in grain marketing. These concerns, as expressed to us by these shippers, are (1) the lack of clearly defined, workable standards for determining whether transportation charges are unreasonable, (2) the cancellation of joint rates, through routes, and reciprocal switching, or unreasonable increases in switching charges, and (3) the inequities resulting from contract rate secrecy.

II. REASONABLENESS OF RATES

I would first like to discuss the frustration some agricultural shippers have expressed with the current rate reasonableness standards.

The rules concerning rate reasonableness present significant obstacles for small shippers without large financial and legal resources. Under current rules, shippers protesting rates must first show that the carrier has market dominance over the traffic involved. The protesting shippers must also address the evidentiary guidelines established by the ICC which require extensive evidence related to the degree of intermodal and intramodal competition. Should the carrier claim that geographic or product competition offers a restraint to rate setting, the shipper must also offer rebuttal evidence that such competition is not effective. The ICC can impose stricter standards of pricing on revenue adequate carriers, although, we note that the ICC has never found a major carrier revenue adequate.

Commission handling of rate cases has been very discouraging for would-be protestants. During our elevator visits and workshop sessions, the general attitude was that filing a rate complaint was difficult, costly, and a waste of time. The following are a few examples of the comments we received. A small grain shipper in our Great Falls, Montana, workshop made the following statement: "A major problem with market dominance is to determine on the basis of the ICC's criteria, whether or not market dominance actually exists. The trade does not understand it, nor do I."

In our Richland, Washington, workshop a small shipper offered this comment . . . "Country shippers don't have the resources to protect themselves against market dominance. Staggers called for definition but ICC changed the rules and it is now fairly arbitrary. Those elevators located farther from the rivers are more apt to be controlled by the railroad. Most shippers lack expertise in this area and would like to see some control by an agency to make sure shippers are not overcharged."

The adequacy for agricultural shippers of the rate reasonableness protections remaining after the Staggers Act has probably not yet been tested. For most of the post-Staggers period, the carriers and the grain trade have been hit by a world-wide recession which reduced traffic and created equipment surpluses. To maintain traffic flows, many grain rates have stabilized, particularly in areas where some degree of rail competition exists. However, with the return of more normal levels of U.S. agricultural exports, the demand for grain will increase and the rate reasonableness protections will become much more important to many agricultural shippers.

The market dominance standards adopted by the ICC in the Ex Parte 320 proceeding are a step in the right direction in alleviating these problems. However, we believe these standards must be further simplified by the ICC and made less burdensome for the small agricultural shipper.

III. COMPETITIVE ACCESS

The second area of concern I would like to discuss has been appropriately named by the ICC, "competitive access." These concerns center on the availability to shippers of services offered by other railroads such as through the establishment and maintenance of joint rates and routes and reciprocal switching arrangements.

For example, a grain shipper with rail service from one railroad may be located only a few miles from another mainline carrier who has access to grain elevators at a major market. However, joint rates and routes between the two carriers may have been unilaterally cancelled by one of the carriers to this major market.

In turn, the elevator operator may find the switching charge to move his grain from his elevator to the other railroad is now prohibitive. Rail access by the elevator manager to this market has now been effectively shut-out.

We do not believe that competitive access problems exist in all areas of the country. For instance, our Kansas study determined that with one or two exceptions, reciprocal switching charges in that state had increased at a rate roughly proportional to increases in rail costs. Also, in some instances, railroads have cancelled through rates and followed with a lower rate to the same destination which benefited shippers. However, in areas of less rail competition, competitive access problems do exist for some elevators.

It has been said that the only regulator in a free market is competition. As regulation is decreased, competition must be effective or else consumers will become subjected to market abuses. Competitive access concerns are particularly valid at this time due to the reduced number of competitors resulting from some carrier consolidations.

Although single line movements are increasing as a result of rail mergers, many grain shippers still depend on multi-carrier routes for marketing. Of the 48 elevators the Department interviewed in 1983, 27 used more than one railroad to reach their market, 14 used single line service, 4 did not respond, and 3 were using trucks at the time. Those reporting an increase in intercarrier problems since 1980 totaled 22, those with no change totaled 7 with 19 in a no response or other category. Six shippers reported the cancellation of reciprocal switching to be a real problem.

The Association of American Railroads recognized that competitive access is a problem in their February 12, 1985 filing with the ICC in the Ex Parte No. 456 proceeding. On page 3 they state ". . . as the Commission is fully aware, the issues of 'competitive access' have been among the most complicated and controversial issues facing the Commission since enactment of the Staggers Rail Act of 1980. In particular, issues arising from alleged route closings, joint rate cancellations, and cancellation of—or increases in—reciprocal switching charges have led to controversies involving shippers, large railroads, regional and short-line carriers. . ."

The record of Ex Parte No. 456 suggests that regulatory problems do indeed exist. This was particularly true in the competitive access issue area. There were a number of filings by agricultural interests which provided specific examples of competitive access problems. Rather than elaboraing on these example, we ask that this committee, in its review of the Ex Parte No. 456 proceeding, review the statements filed by the Fertilizer Institute, the National Grain and Feed Association, the Chemical Manufacturers Association, Indiana Grain, Cargill, and the short line railroads.

The Ex Parte No. 456 proceedings is a example of a recent trend to achieve a negotiated solution to these problems. In those proceedings, the issues of competitive access, jurisdiction, and rate regulation for small agricultural shippers were largely left unresolved. Two agreements were reached, however, one between the Association of American Railroads (AAR), the National Industrial Transportation League (NITL), and the Chemical Manufacturers Association addressing competitive access problems; and another between the AAR, the NITL, and the American Paper Institute, addressing market dominance standards. The ICC, in response to petitions from the parties to these agreements, initiated proceedings to consider adopting the agreed upon terms as ICC standards. On behalf of the Secretary of Agriculture, my office has filed comments in each of the proceedings stating, in essence, that although we generally support negotiated solutions to these problems, these agreements do not set specific standards for the Commission to follow and are not fully responsive to the problems of small agricultural shippers.

If a resolution of competitive access problems, by negotiation or otherwise, is not made soon, the problems may be with us for some time. Currently, national attention is focused on the implementation of the Staggers Act. Numerous trade associations have passed resolutions directed at changing the Act, several bills have been introduced to modify it, groups have been formed to lobby for change and the ICC initiated a major proceeding to attempt a negotiated settlement of rail/shipper differences. We do not believe that any changes are required in the Staggers Act. We believe that the railroads must be more responsive to the concerns of small agricultural shippers and that the ICC in administering these regulations must give more consideration to the needs of the small captive shippers.

An indication of how the ICC has been ruling in competitive access cases can be gleaned from the Annual Reports issued by the agency. In 1981 the Suspension Board handled 14 cases involving the cancellation of joint rates. None of these cancellations were suspended. In 1982, 25 cases were reviewed and none were suspended. In 1983, there were 33 cases and 3 were suspended and in 1984, only 5 were reviewed and 1 suspended. As explained in the Annual Report, Section 1075*a* of Title 49 to the U.S. Code gives the carriers an absolute right to cancel when their revenue to variable cost ratio falls below 110 percent.

Section 10705 requires that the Commission give consideration to the public interest in through route or rate cancellations. According to the ICC, many of the 1983 and 1984 cases dealt with revenue to cost ratios of over 110 percent and therefore all cases were decided under Section 10705, the public interest section. The bottom line is that cancellations were denied in only 4 of 76 cases in the 4-year period. However, we believe that under the new standards recently established by the ICC, some of the above cases might have been suspended.

A small shipper in Illinois offered this view in our Champaign workshop "Joint service cancellation is one of the things that has changed country elevator operations more than anything else. With joint connections and reciprocal switching in place, you often have the option of several markets. When these services as cancelled or priced beyond practical usage youl become a one market merchandiser."

The traffic manager of a large shipper had this to say in our Bismarck, North Dakota, workshop "The impact on traditional markets of Staggers was the cancellation of joint rates, through routes, and reciprocal switching. The integrated rail system in the United States that we had prior to Staggers is turning into a series of single line railroads, making processing plant shippers and receivers pay a penalty for the inability to negotiate a joint rate route. Individual railroads are the sinews and ligaments of an integrated transportation system which made this country great. Unfortunately the cancellation of rates and routes is going to tear this system apart."

We are encouraged by the new competitive access rules adopted by the ICC in Ex Parte No. 445. We have urged the Commission, however, to employ greater specificity in defining competitive access guidelines with a consideration of the regulatory burden on small captive shippers.

CONTRACTS

The third major concern I would like to address is contract ratemaking. Some agricultural shippers are taking full advantage of the ability to contract granted by the Staggers Act, as evidenced by the rapid increase and extensive use over the past few years of contract ratemaking on grain and grain products. Our Kansas study indicates that contracting has been a real advantage for these shippers by giving them substantial rate discounts, and by allowing them to pursue innovative marketing strategies and to work out service problems directly with carriers. Many other agricultural shippers, however, are concerned about the equity of the rules under which this new type of ratemaking has been permitted.

In general, we support the concept of contracted rail service. No one wants to return to the formalisms and rigidity that were hallmarks of pre-Staggers rail regulation and tariff-based rail rates. But in spite of the advantages rail contracting has given some segments of grain marketing, we believe that the overall benefits of contracting to small grain shippers are questionable, at least with the current disclosure rules. For agriculture, the crux of the issue is the impact of this method of rail pricing on net prices received by farmers.

The ability to contract has resulted in substantial rate concessions and innovative pricing and service packages for some grain shippers. Our research with the ICC on Kansas wheat contracts suggests that shippers with contracts have obtained a transportation price advantage of 17% as compared to tariff rates. Based on our experience, small single-location shippers generally are not participants in contract ratemaking.

Our research also suggests that the benefits of rail contracting are being represented in increased net prices paid to Kansas farmers particularly at high density shipping points. Although further research is required, it is not clear whether rate reductions are being passed through in some country locations. In some cases, local elevator margins have been squeezed by need to match the competition while paying relatively higher non-contract transportation charges.

Although there have been benefits to agriculture from rail contracting, we believe the conditions under which contracting is permitted should be modified by the ICC to accommodate the interests of small shippers. The shift from tariff-based rail rates to contract rates has been a dramatic one for small shippers, many of whom were used to functioning in a market environment based on the "visibility" of published rail rates applicable to large and small shippers alike. A liberalization of contract disclosure rules would ease the adjustment process of these shippers to contracted rail service and help maintain at least the current degree of competitiveness in grain marketing. We strongly support and encourage the current negotiations between the National Grain and Feed Association and the Association of American Railroads to achieve disclosure rules equitable to all agricultural shippers, regardless of size.

IV. CONCLUSION

In conclusion, I would like to reiterate that we support the Staggers Act as it is. We feel that Congress should be commended for enacting this landmark legislation. We have detected only a few trouble spots that are having a detrimental impact on small agricultural shippers. Although rail deregulation has benefited agriculture, for some small elevator operators it has resulted in economic injury and a shrinking market availability. Some elevator operators believe that the implementation of Staggers has also seriously reduced recourse against carrier abuses. We believe that the ICC needs to make some adjustments in the regulatory framework. Proper rules need to be established and those rules should be administered in a manner that recognizes the needs of the small shippers, the carriers and the public. Agricultural shippers do not want free transportation service or even service that is unprofitable for the carriers. They need efficient, competitively priced service to get their products to market.

[The following information was subsequently received for the record:]

Question of Senator Pressler and the Answer

Question. Could you supply for the record the results of the alternative transportation costs for moving various types of grain from the points described below to Duluth and Minneapolis, MN:

(a) from Rapid City, Philip, and Midland, SD (assuming the Ft. Pierre to Rapid City segment is abandoned);

(b) from Rapid City, Philip, Midland, Miller, Huron & Brookings (assuming the entire C&NW line from Rapid City to Minnesota is abandoned);

(c) from Aberdeen, Houghton, Hecla, & Oakes (assuming the Aberdeen to Oakes, ND line is abandoned).

Answer. It is not possible for us to supply the exact rates to and from the points named in your question since some of them are not published. According to the shippers we contacted in that area, the rail rates to the Twin Cities and the Twin Ports from the South Dakota points range between 50 and 70 cents per 100 pounds (30 to 42 cents per bushel). Trucks are fairly competitive from the area, so their rates run a few cents above or below the rail rates depending on how badly they need the traffic. However, the presence of rail service keeps the truck rates down and visa versa.

If rail service were to be abandoned on the mentioned lines, there would a strong tendency for rates to increase. Oakes, ND, should not have a problem since it is served by the BN and the SOO railroads in addition to the CNW. Huron and Aberdeen, SD, would still be served by the BN, but rates could increase due to the loss of intramodal competition. The remaining locations would lose all of their rail service and with no intermodal competition, truck rates would undoubtedly increase.

The amount rates would increase at those points where rail service is eliminated would vary. The option to truck to a faculty located on a rail line would still exist. This, however, would increase costs since there would be little if any savings on the rail rate while increased expenses would be incurred transporting and handling the grain an extra time. Such an increase could amount to 20-25 cents per 100 pounds.

All of the towns you have listed in your question are located on CNW lines that the L.B. Foster Co. is negotiating to purchase. Further talks between the involved parties are to be held this month (January). From our viewpoint, it appears the purchase will be consummated. If it is, competition will be maintained in the area and rates should be favorably influenced.

QUESTIONS OF SENATOR LONG AND THE ANSWERS

Question 1. Mr. Fitzpatrick, your office recently released a study of the impacts of rail deregulation on the marketing of Kansas wheat. The report concludes that the reduction of rail rates for Kansas grain was primarily due to competition among the railroads. Have agricultural shippers elsewhere enjoyed these benefits?

KANSAS STUDY

Answer. Our recent report on the impacts of rail deregulation on the marketing of Kansas wheat attributes the reduction of Kansas rail rates on grain to many factors, such as the reduced export flow of wheat, surpluses of transport equipment, changes in transport technology and cost relationships, and others. Intra-rail competition in Kansas was also a factor which reduced rail rates since 1980, particularly contract rates. While we believe that other areas of the country, with less rail competition, have also benefited from general reductions in the level of tariff rates, we do not believe that these areas have been the beneficiaries of the extensive rate discounting through rail contracting that occurred in Kansas. Rail rates for agricultural shippers in other areas also appear to have declined, but arguably not to the extent of the rates for Kansas shippers.

Question 2. In comments filed before the ICC in the *McCarty Farms* case on November 10, 1983, authored by the Office of Transportation for Secretary Block, there appear the following statements:

During the past 10 years, the level of difficulty for the average shipper in proving a rate reasonably high has gone full cycle from ridiculously easy all the way to impossible. (p. 2)

The ICC's interpretation and administration of the statutory provisions [of the 4R and Staggers Act] has . . . made it virtually impossible for shippers to prevail in this type of proceeding [referring and rate reasonableness cases]. (p. 3)

As a practical matter, the stand alone cost theory could not be applied to the grain industry and attempts to implement the proposal would present an unreasonable burden for grain shippers and could yield negative economic consequences for the Nation. (p. 4)

Agriculture's concern is that the carrier's revenue needs are being overstated by the ICC and that the ratemaking standards proposed in this proceeding will lead to carrier abuses. (p. 7)

The primary reason the [Coal Rate] guidelines are not appropriate is because they are predicated upon a desired return on investment for the carriers that is unrealistically high. (p. 8)

That is an impressive catalog of regulatory abuses by the ICC. What has the ICC done in the past year or two to alleviate these officially articulated concerns of Secretary Block, and why shouldn't Congress address them legislatively? What has the Commission done about its "unrealistic" revenue adequacy test? What has it done about the "unreasonable burden" imposed by the Coal Rate Guidelines? Are you suggesting that two years having passed since these comments were filed, and nothing having been done about the concerns raised by them, that we in Congress should do nothing?

RATE REASONABLENESS STANDARDS

Answer. The comments the U.S. Department of Agriculture made in the *McCarty Farms* case were valid at the time and we still have some of the same concerns. However, a number of developments have taken place in the interim that lead us to believe that these concerns can be satisfied by means other than opening up the Staggers Rail Act.

In late 1984, the Interstate Commerce Commission (ICC) opened the proceeding docketed Ex Parte No. 456, *The Staggers Rail Act of 1980—Conference of Interested Parties.* This proceeding was initiated primarily because of rising public discontent with the way the ICC was regulating, or not regulating, the railroads. Although the proceeding produced limited results, extensive public participation created an awareness that something needed to be done to give shippers more consideration in regulatory matters.

One spinoff from the Ex Parte 456 proceeding was a negotiated agreement between the Association of American Railroads, representing the carriers, and several shipper organizations addressing rate reasonableness standards applied by the ICC. This agreement was given public consideration by the ICC under docket Ex Parte No. 320 (Sub-No. 3) *Product And Geographic Competition.* The USDA filed comments in this proceeding asking for and suggesting specific, definitive standards for rate reasonableness determination. The rules adopted by the ICC were not very definitive; however, they are an improvement and should be given a trial period to determine their effectiveness.

The rules adopted by the ICC in Ex Parte 320 require more specific evidence related to intramodal, intermodal, geographic, and product competition than was previously required. Additionally, they shifted the burden of proof for the existance of geographic and product competition from the complainant to the carrier. We believe these new standards can work if the Congress directs the ICC to give equal consideration to the needs of the carriers, shippers, and the public, as required by Section 3 of the Staggers Rail Act.

STAND ALONE COST

The stand alone cost test does not apply to grain or other agricultural shipments. We do not believe that it is a reasonable standard and we will oppose any effort by the ICC to apply it to agricultural traffic. The stand alone cost theory was not mandated by The Staggers Act.

REVENUE ADEQUACY

The ICC has done nothing about the unrealistic revenue adequacy test. Circumstances have changed substantially, with regard to applying revenue adequacy standards since passage of the Staggers Act in 1980 rendering the test somewhat obsolete. The revenue adequacy standard is primarily applied in cases involving rate reasonableness. For a number of reasons, many movements are excluded from rate reasonableness tests. For example, the reasonableness of contract rates is never an issue that has to be considered by the ICC. In 1980, very little grain was moving under contract rates. In 1985, approximately 50 percent of all rail grain movement was under contract. Additionally, there are many published multicar and time-volume rates that are rarely protested. Since contract rates are generally discounted and multicar and time-volume rates are among the lowest rates, it leaves only a small percentage of rates that are likely to be protested and thus subject to the revenue adequacy test. It does not appear reasonable that the ICC should assist the carriers in attaining adequate revenues by propping up the rates on a small percentage of normally higher rated traffic when the carriers offer bargain or discounted rates on substantial amounts of other traffic. The Railroad Accounting Principles Board may or may not produce findings that will alter the revenue adequacy test now being used. We believe the ICC should be given direction on how and when to apply the revenue adequacy test.

Question 3. Please address the *McCarty Farms* case. Those grain shippers have spent several hundred thousand dollars, waited over five years, have had to have the State of Montana appropriate public funds to keep the case alive, and now they have to start all over again. Is that fair to the nation's farmers? What can we in Congress do to help them?

THE "MC CARTY FARMS" CASE

Answer. The experience of the state of Montana and the grain shippers involved in the *McCarty Farms* case with the current rate reasonableness standards points out the need for these standards to be simplified and made less burdensome for agricultural shippers. It is not fair to agricultural interests that the only avenue for protesting the reasonableness of rail rates is so expensive and time-consuming. Accordingly, our testimony before this Subcommittee in these hearings and before the ICC in the *McCarty Farms* case has been unequivocal in calling for a simplification of this procedure, which we believe could be done by the ICC under its current statutory authority.

Question 4. Do you think stand alone cost is a fair measure of rate reasonableness? Do you know of any farmer who thinks it is?

STAND ALONE COST

Answer. As stated above, the Department does not think stand alone cost is a fair measure of rate reasonableness and we will oppose its use on agricultural traffic. We do not know of a single farmer or agricultural shipper that supports its use. Many have spoken out against it.

BEST COPY AVAILABLE

Question 5. Perhaps Secretary Block's November 10, 1983 comments in the *McCarty Farms* case hit the heart of the issue.

"There are indications that the railroads are currently earning adequate revenues to attract investment capital. Agricultural producers, particularly grain producers, do not enjoy this position. The producer receives the market price for his grain less transportation and handling costs to that market. * * * Should the proposed guidelines [the Coal Rate Guidelines] be applied to the cases in question, or any other grain cases, an even greater imbalance would be created between carriers and shippers than already exists. On one side would be the carriers with a "mandated" return on investment and considerable ability to increase rates with immunity from suspension. On the other side would be the agricultural producer with a negative return on investment and virtually no recourse against rate increases." (p. 7)

Isn't this the heart of the issue—whether the railroad has the ability to take more of the delivered price of grain than the farmer who produces it? Has anything happened in the intervening two years to change Secretary Block's assessment?

RAILROAD PRICING

Answer. Railroad pricing can only be controlled in two ways; either through regulation or by the existence of competition. Typically, trucks are competitive with rail for short-distance hauls. For some long haul movements, barges can compete with rail. We feel some amount of regulation is needed on long haul traffic to protect those shippers of agricultural commodities located away from the river that are served by only one rail carrier. We are not in total agreement with the rate reasonableness standards adopted by the ICC in the Ex Parte No. 320 proceeding, but they are an improvement and could work with proper interpretation, or perhaps further modification, by the ICC. The ICC should be directed to give more consideration to shipper needs in regulatory matters. A delicate balance is needed to protect captive shippers from rate abuses while allowing the carriers enough pricing freedom to maintain financial viability.

Question 6. Are you familiar with the Commission's *Midtec Paper* decision on reciprocal switching and other competitive access issues? Do you know that the National Industrial Transportation League, which worked out that competitive access compromise with the AAR, has gone to court saying that the *Midtec* case "largely cancel[s] out" its compromise? Does that give you any pause when you tell us that a negotiated compromise on contract disclosure is the answer to the grain shipper's problems? In other words, what makes you think the ICC will live up to that compromise any more than it did the compromise on competitive access?

"MIDTEC PAPER"

Answer. There is still some hope for a decision favorable to the shippers in this case. The ICC has recalled this case from the courts in order to give the matter further consideration under the competitive access rules adopted in Ex Parte No. 445.

Question 7. Please respond to the testimony before the Subcommittee of Evans Grain Company, based in Salina, Kansas, which lacks your enthusiasm for the National Grain & Feed Association—Association of American Railroads negotiated approach to contract disclosure.

EVANS GRAIN TESTIMONY

Answer. The testimony of Evans Grain before the Subcommittee does not fault the negotiated approach to the contract disclosure issue, which we strongly supported and encouraged in our statement, but rather suggests that the compromise does not go far enough in requiring the disclosure of additional terms.

We are not surprised that all segments of the grain community do not completely embrace the National Grain and Feed and Association of American railroads agreement on contract disclosure. As Mr. Harding of the National Grain and Feed stated in his testimony, "first of all, the agreement is a compromise within the Grain and Feed Association and between our association and the AAR, so not everything that everybody wanted is covered, and in many cases there are things in there that people did not want." Indeed, there was even testimony before the Subcommittee (Mr. Oman, Scoular Grain Company) opposing any change in the amount of information made public on rail contracts.

We believe, however, that the compromise does reflect a liberalization of the contract disclosure rules, which we called for in our statement before the Subcommittee, and will ease the adjustment process of smaller shippers such as Evans Grain to contracted rail service.

The **Chairman**. Next we have a panel, and Senator Long has asked that we wait until 2 o'clock for the panel to testify, so we will break now until 2 o'clock.

[Recess.]

AFTERNOON SESSION

The **Chairman**. We have Mr. Haupt, Mr. Mitchell, and Mr. Melville. Gentlemen, thank you all for patience in waiting so long today.

Would you like to go first, Mr. Haupt?

STATEMENTS OF RICHARD HAUPT, DIRECTOR OF TRANSPORTATION AND TRAFFIC, FORD MOTOR CO., ON BEHALF OF NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE; ED MITCHELL, PRESIDENT, PEPCG, ON BEHALF OF CONSUMERS UNITED FOR RAIL EQUITY; AND W.G MELVILLE, DIRECTOR OF PHYSICAL DISTRIBUTION, KENNECOTT, ON BEHALF OF COMMITTEE AGAINST REVISING STAGGERS; ACCOMPANIED BY JOHN ARCHER, DIRECTOR OF LOGISTICS, CROWN ZELLERBACH

Mr. **Haupt**. Thank you, Senator.

Good afternoon. My name is Richard Haupt. I am director of transportation and traffic for the Ford Motor Co. in Dearborn, MI. I am appearing today on behalf of the National Industrial Transportation League, since I served as the league's shipper coordinator in negotiating the private sector agreement on competitive access for the railroad industry.

The league is pleased indeed to be here today to present its views on the Staggers Rail Act and the private sector agreements negotiated and endorsed by the League which were pending ICC review in Ex parte No. 445.

These private sector agreements mark an important turning point in the evolution to a market disciplined railroad industry. They demonstrate that, freed of regulatory constraints, carriers and shippers are able to resolve issues of major transportation importance.

In supporting these agreements, we know of course that they are not perfect, nor do they solve every competitive access or market dominance problem facing the shipping community. We also recognize they are based on the understanding that carriers and shippers remain committed to resolving their differences through negotiation, with the ICC being used only when goodfaith efforts cannot span basic differences.

However, we believe that these agreements provide a timely, simple framework for dissolving disputes over rate and route cancellations, an equally effective mechanism for fostering intrarailroad competition through increased use of reciprocal switching arrangements, as well as a means of mitigating the most onerous burdens and seeking agency review of actual or potential abuses of the railroads' market power.

The agreements also provide the ICC with a means of demonstrating its commitment to assuring balanced administration of the Staggers Act. We are pleased that the agency just yesterday issued its written decisions in these proceedings so that they can now be put into practice. If the ICC fails to realize the basic objectives of these agreements, Congress then becomes the only forum for these controversies.

In conclusion, the league believes that the Staggers Rail Act which mandated a balance of shipper and carrier needs to assure a healthy, competitive railroad industry has worked well in those situations where competition, especially intrarailroad competition, exists. However, it has been less successful in those instances where effective competition is absent.

We believe that this dichotomy is due in large part to the Commission's interpretation and administration of the act, specifically its failure to give adequate emphasis to the 1980 reform law's goal of maintaining and fostering competition in this industry.

A recent example of this is the Commission's decision in the *Mid-Tech* case, but indeed we are pleased that the ICC has asked for the case to be remanded and hopefully there will be a better decision coming out.

The agency now has the opportunity to help restore the balance mandated by Congress by acting quickly and decisively on the private sector agreements. If it does so, the benefits extend beyond these two important issues. The Commission will have created a confidence which is needed to foster additional agreements aimed at resolving the other controversies resulting from its previous interpretation and administration of the act.

If it fails to do so, the agency will force the policy debate upon Congress, since no other forum for relief will be available. While we would prefer a negotiated regulatory solution to our problems, the league will not hesitate to seek congressional action to assure that the Staggers Act's competitive objective become a reality for all shippers.

The league would note that it is continuing its discussions with the Nation's railroads on some of the other controversial Staggers Act issues identified by Chairman Danforth in Senate Joint Resolution 331 which is revenue adequacy, rate reasonableness, and further refinements to market dominance procedures.

We hope that these discussions will lead to other private sector agreements which can be presented to the ICC for its review and action. The league thanks you for this opportunity to present the views of the shipping community and looks forward to working with you and your staff to assure that our mutual goal of a market disciplined rail industry becomes a reality.

I would, of course, be glad to answer any questions.

[The statement follows:]

STATEMENT ON BEHALF OF THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

Chairman Packwood, Members of the Subcommittee: Good Morning, my name is Richard Haupt. I am director of transportation and traffic for Ford Motor Company, Dearborn, Michigan. I am appearing today on behalf of The National Industrial Transportation League. I served as the League's shipper coordinator in negotiating the private sector agreement on competitive access with the railroad industry.

The League is a voluntary organization of shippers, shippers' associations, boards of trade, chambers of commerce, and other entities concerned with the purchasing of transportation services. It is the only nationwide organization representing shippers of all sizes and commodities using all modes of transportation to move their goods in interstate and international commerce. Its members, directly or indirectly, are responsible for the routing of about 80% of the country's commercial freight.

The League is pleased to be here this morning to present its views on the Staggers Rail Act, and the Act's marketplace effects over the past five years. As we have testified at previous oversight hearings, the League believes that the Act provides a workable balance between the goals of assuring the railroads' revenue adequacy and of maintaining and fostering effective competition within the industry. Where competition, especially intra-railroad competition, exists, the Act appears to be working well.

In these instances, it has justified Congress's faith in the ability of the marketplace to effectively regulate transportation services. However, in those instances where competition is absent, our members continue to be concerned about the Interstate Commerce Commission's stewardship of this legislation.

The past five years have seen an increasing emphasis on competitive access concerns. In the early stages of the Act's implementation, our primary focus was the rate equity issues such as market dominance, rate reasonableness, and revenue adequacy. However, at our last Annual Meeting, the Staggers Rail Act policy debate centered on competitive access issues such as rate and route cancellations, reciprocal switching, and trackage rights, and the need to pursue legislative changes.

The membership's concern with competitive access issues prompted the League to initiate negotiations with the railroad industry which led to the competitive access agreement currently under consideration in Ex Parte No. 445 (Sub-No. 1) *Intramodal Rail Competition.*

The desire to explore all non-legislative remedies to our members' concerns with the Act's administration prompted the League's endorsement of the agreement negotiated between the railroads and the American Paper Institute currently under consideration in Ex Parte No. 320 (Sub-No. 3) *Product and Geographic Competition.*

Perhaps one of the Act's greatest benefits is that it has led to a rethinking of the traditional relationships between the railroad and shipping communities. Under the environment created by strict regulation, carriers and shippers would have looked to Washington, rather than themselves, for solutions to their marketplace problems. With five years' experience under the Act's more market-oriented philosophy, carriers and shippers have learned to explore new solutions to common problems.

These private sector agreements mark an important turning point in the evolution to a market disciplined railroad industry. They demonstrate that freed of regulatory constraints, carriers and shippers are able to resolve issues of major transportation importance.

The competitive access agreement would provide the following mechanisms to address problems caused by joint-line rate and route cancellations:

A carrier must provide 45 days' notice of a cancellation. Upon request of an affected party seeking an explanation of or justification for the action, the canceling carrier must provide that information within 10 days.

Prior to seeking ICC relief from a cancellation, the affected party and the canceling carrier first must seek to negotiate a settlement to their dispute. If the matter is not resolved within five days after the request for negotiation, then the affected party is free to seek Commission action on the matter.

The ICC is empowered to suspend and/or investigate a proposed cancellation if it determines that the affected party has or will use the rate or route at issue and that the cancellation would eliminate effective railroad competition for the traffic between that origin and destination.

The criteria for investigating a proposed cancellation is specified and agency investigations are required to be made on an expedited basis.

In addition, the agreement provides a mechanism for the establishment of joint-line rates and routes as well as reciprocal switching arrangements. This mechanism includes criteria about an affected party's use of the rate or route and the new rate's or route's impact on competition within the industry. It also limits the use of certain ICC findings in certain court proceedings under the antitrust laws involving the same facts or controversies.

Reciprocal switching normally occurs in a terminal district or other area where several railroads provide service. It essentially is a cooperative working arrangement between railroads so that goods carried by one railroad can be picked up from or delivered to the facilities of a shipper located on another railroad.

The product and geographic competition agreement would make changes in the ICC's handling of market dominance proceedings. A market dominance finding must be made prior to agency action on rate reasonableness issues.

The agreement would shift from shippers to carriers the burden of proof for showing that the presence of product and geographic competition is sufficiently strong to prevent anticompetitive actions by the railroads. In addition, the agreement provides a clearer understanding of how the ICC will treat evidence on product and geographic competition.

It is understood that product and geographic competition are concepts used in antitrust law. They are premised on the belief that the ability to buy other products or to buy the product at issue from other sources can create pricing pressures which can prevent abuses of market power.

In supporting these agreements, we know that they are not perfect, nor do they solve every competitive access or market dominance problem facing the shipping community. We recognize that they are based on the understanding that carriers and shippers remain committed to resolving their differences through negotiation, with the ICC being used only when "good faith" efforts cannot span basic differences.

We believe that these agreements provide a timely, simple framework for resolving disputes over rate and route cancellations; an equally effective mechanism for fostering intrarailroad competition through increased use of reciprocal switching arrangements; as well as a means of mitigating the most onerous burdens in seeking agency review of actual or potential abuses of the railroads' market power.

They also provide the ICC with a means of demonstrating its commitment to assuring balanced administration of the Act. We hope that the agency will shortly issue its written decisions in these proceedings so that they can be put into practice. If the agency fails to realize the basic objectives of these agreements, Congress becomes the only forum for these controversies.

In conclusion, the League believes that the Staggers Rail Act, which mandated a balance of shipper and carrier needs to assure a healthy, competitive railroad industry, has worked well in those situations where competition, especially intra-railroad competition, exists. However, it has been less successful in those instances where effective competition is absent.

We believe that this dichotomy is due, in large part, to the Commission's interpretation and administration of the Act, specifically, its failure to give adequate emphasis to the 1980 reform law's goal of maintaining and fostering competition in this industry.

A recent example of this is the Commission's recent decision in the *Midtec* case. Despite requests by the shipper and a railroad interested in providing competitive service, the agency failed to find that the service was in the public interest and denied the application. Some observers believe that the *Midtec* decision actually inhibits the fostering of competitive service because they believe that new, stricter burdens of proof have been imposed in these proceedings.

The agency now has the opportunity to help restore the balance mandated by Congress by acting quickly and decisively on the private sector agreements negotiated on competitive access and the use of product and geographic competition. If it does so, the benefits extend beyond these two important issues. The Commission will have created the confidence needed to foster additional agreements aimed at resolving the other controversies resulting from its previous interpretation and administration of the Act. If it fails to do so, the agency will force the policy debate upon Congress, since no other forum for relief will be available. While we would prefer a negotiated, regulatory solution to our problems, the League will not hesitate in the future to seek Congressional action to assure that the Staggers Act's competitive objectives become a reality for all shippers.

The League would note that it is continuing its discussions with the nation's railroads on some of the other controversial Staggers Act issues identified by Chairman Danforth in Senate Joint Resolution 331, such as revenue adequacy, rate reasonableness, and further refinements to market dominance procedures. We hope that these discussions will lead to other private sector agreements which can be presented to the ICC for its review and action.

The League thanks you for this opportunity to present the views of the shipping community, and looks forward to working with you and your staff to assure that our mutual goal of a market-disciplined rail industry becomes a reality. I would now be glad to answer any questions you may have.

The **CHAIRMAN**. Thank you, Mr. Haupt.

Mr. Mitchell.

Mr. **MITCHELL**. Thank you, Mr. Chairman. Mr. Chairman, thank you very much for scheduling this hearing and for affording the Consumers United for Rail Equity an opportunity to testify.

I should make it clear that although I am president of an investor-owned electric utility, I am not here representing the utility's interests as such. I am representing the interests of our consumers, because whether the rail rates for coal go up or down, such rates are ultimately paid by our consumers. The level of such rates does not make any financial difference to the industry itself. And that is true of all of our investor owned and publicly owned utility members.

This is strictly a consumer issue, and we have been joined in our efforts by a great many parties that normally we argue and disagree with: utility regulators, consumer advocates, labor, Governors, and mayors. A great, wide, broad coalition has been put together because we all share a common interest.

Mr. Chairman, dealing with one reference to Potomac Electric Power Co., I would like to address Senator Pressler's question this morning as to how much rail rates have increased. He had an answer put to him. Minimally; about the cost of inflation, generally.

Let me tell you, sir, that when you talk to the ICC or you talk to the railroad representatives about rates, that is what they talk in terms of—averages. What you have to look at is the specific coal-hauling road, the specific road that you are talking about, and then ask that question.

Just to give you one answer for Pepco, from 1979 to 1984, our rail transportation rates increased 80 percent. In that period of time, the Consumer Price Index went up 43 percent. In that same period of time, our electric rates went up 32 percent. Now, we did a very good job, I think, on the electric rates, but the whole point is that you cannot look at averages; you have to look at specifics, because the captive shippers are not the majority of all of the shippers that use the railroads. And when you talk in terms of averages, the impact on the captive shipper is lost.

We listened this morning, Mr. Chairman, to Chairman Taylor talk about how the course is charted, the ship is moving, so give them time. Mr. Chairman, they have had 5 years. My suggestion, to carry his statement just a little bit further, is that the ship is sinking.

What he says basically is "trust me, trust me, trust the Commission; 5 years or so down the road, we will have everything all taken care of." We don't agree with that, Mr. Chairman. We have reached the limit, and if this Congress does not fix the problem, 5 years from now we will be right back here with the same kind of argument.

The system is broken, no question about it. The ICC has been guilty of outrageous behavior over the last 5 years, and that behavior is continuing today. I think as a consumer I would have to say I am a little angry about the situation. I think, were I a Member of the Congress, I would be furious about it, for two reasons: one, you go back to 1980, this Congress went through a great deal of trial and tribulation and effort and debate to arrive at a satisfactory method to reach the goals of financial health for the railroads.

Now, the compromise that was built into that method and that allowed the Staggers Act to be adopted included the Long-Cannon amendment and other provisions to protect the captive shipper. Up to this point, those provisions have been totally abrogated by the ICC. The ICC has been extremely diligent in assisting the railroads to reach a level of financial health; they have done nothing much on the other side of the coin.

Further, Chairman Danforth last year introduced Senate Joint Resolution 331. In effect, the resolution told the ICC to clean up its act and it dealt with, as discussed this morning, revenue adequacy, market dominance, rate reasonableness, competitive access, and a few other things.

The answer that you received this morning as to what the Commission has done is a little bit nebulous. I would say to you, sir, that the Commission has done virtually nothing on the items that were included in that joint resolution. It has not been too long ago that Chairman Taylor said the Commission will not look at revenue adequacy. Today, for the first time, I heard him say they plan to revise it slightly.

They did make a change in market dominance, and that change, I think, is reflected in the latest amendment to the Consumer Rail Equity Act. As far as rate reasonableness and competitive access, they may even have regressed a little bit on the competitive access.

So, Mr. Chairman, we don't trust them. Abuse in pricing is obvious to any objective reviewer. In my testimony I describe 19 cases where the return on investment ranges from 58 to 157 percent. This is a smoking gun. This is not just a project of future impacts.

Reference was made also this morning to the DOE study and the conclusion that it reached. If you read two parts of that study, you will get two different answers. The main body of the text will indicate to you that clearly it recognized the dangers and the hazards and the abuses that are ongoing at the Commission. Then you read the executive summary and it points out that there is no smoking gun.

We made some calculations that show indeed what the return on investment is for the haulage of the companies that were reviewed by the Department in that study. DOE did not make the calculations; we made them, and they are in my written testimony before this committee, showing outrageous returns on investment.

No railroad has been found to be revenue adequate; no captive shipper has been found in any final Commission ruling, which holds that its rates were unreasonable. All of these things have been talked about this morning.

The administrative law judges of the Commission have told us several times that we are wasting our time; that when you go before that Commission, you are doomed. Shippers know, with the thrust of the Commission, that they are not going to find any rate unreasonable. They have in effect told us "don't waste your time and your money by putting on these terribly expensive and burdensome cases before this Commission."

Now, much has been talked about this morning on several measures. If I could have the time, sir, to touch on just two or three. The first one is revenue adequacy. A great deal has been said about that this morning. The ICC has a test that is unique, to be polite about it; it is bizarre, to be accurate. It is not followed by any other regulatory utility commission in this country, and it is not likely to be. It understates the financial health of the railroads significantly.

Mr. Dempsey made a statement earlier on this morning that he would be happy to perform as a public utility and have a guaranteed return equal to the current cost of capital. Well, Mr. Dempsey needs some education. A utility is not guaranteed to earn anything. A utility is afforded an opportunity to earn a rate of return. But the key—and Mr. Dempsey is deliberately obfuscating this issue, and so too does the ICC—the key is the use of the "current" cost of capital. Current cost of capital, in their terminology, means the current cost of debt. Any other regulated industry, every utility, for example, is regulated on the embedded—contractual—cost of debt. And, Mr. Chairman, that makes a tremendous difference when you calculate your cost of capital.

Another key factor which was not brought out much this morning is to what do you apply the cost of capital? What is the investment base? In the utility industry, it is very strictly regulated. It is controlled very, very carefully and reviewed by public service commissions. And what do we see when we get to the railroads? Do you know that in the investment base of the railroads are deferred taxes? You know, sir, this we view deferred taxes as obviously an interest-free loan to the railroads, as it is to us. In a utility's case, our utility's case, as all others, deferred taxes reduces your investment base before you apply the cost of capital to obtain your return on investment. Not in the railroad case, sir. It is not. They want to continue to compute their return on investment on that inflated basis.

Now, so saying, sir, all of the numbers that you have heard this morning about the railroad's return on investment are understated in the railroad's case by a factor, I would suggest to you, of some two or three times possibly.

As though the revenue adequacy test that is currently used by the railroad is not enough to guarantee that they will be revenue inadequate, the ICC has proposed changes to make other kinds of calculations which will change the investment base from historical cost to reproduction cost. One can argue whether the Commission would then apply current cost of capital or a deflated cost of capital to that number, but either way, if this is done, it is going to further guarantee that there will never be a revenue adequate railroad in this country.

The stand-alone cost test is still in existence as a measure of rate reasonableness. This has been described this morning, sir. We consider it absurd, and something has to be done about this.

Mr. Chairman, I know that my time is up. Let me say that the only way to have something done is for the Congress to act, because it is clear that the Commission is not going to. We are deeply concerned about this problem. We thank you very much, Mr. Chairman, for the opportunity to make this brief presentation to you.

[The statement follows:]

Statement of Edward F. Mitchell, on Behalf of Consumers United for Rail Equity

Mr. Chairman and members of the Committee, my name is Edward F. Mitchell. I am President of Potomac Electric Power Company. I also serve as Chairman of Consumers United for Rail Equity and appear before you today in that capacity. The members of Consumers United for Rail Equity and the members of the C.U.R.E. Coalition appreciate the opportunity to present our views to you today concerning the implementation of the Staggers Rail Act.

We believe the Interstate Commerce Commission's implementation of the Staggers Rail Act has focused almost excusively on improving the financial health of the railroads and has failed to achieve two other major goals of the Staggers Act: The protection of captive shippers against unreasonable rail rates and the assurance of maximum competition between the railroads. The Staggers Act was a compromise that balanced the need for partial deregulation of the railroad industry with the need to protect captive shippers against unreasonable rates and the need to maintain railroad competition. Since efforts to achieve Commission action that implements this balance have not been successful, the members of C.U.R.E. and the C.U.R.E. Coalition now support the enactment of the Consumer Rail Equity Act, S. 477, which was introduced by Senators Andrews, Long, Ford and Stevens and has now been cosponsored by six members of this Committee, including Senators Exon, Gore and Rockefeller.

CONSUMERS UNITED FOR RAIL EQUITY

Consumers United for Rail Equity (C.U.R.E.) is a non-profit organization of shippers that became active in July, 1984. The objectives of C.U.R.E. are to unite consumers, captive shippers of bulk commodities, and other shippers in an effort to inform the public, members of Congress and the Administration concerning the problems encountered under the Commission's implementation of the Staggers Act and to work for responsible, effective legislation that will correct these problems. Today, C.U.R.E. is composed of 80 members of which 39 are investor owned electric utilities, 16 are publicly owned electric companies, 7 are rural electric generation and transmission companies that serve rural electric cooperatives, and 18 are coal producers. Our members operate in 35 states, collectively account for 46% of the nation's generating capacity and produce more than 25% of the nation's annual coal production.

THE C.U.R.E. COALITION

The C.U.R.E. Coalition is a broad-based group of organizations joined together to work with C.U.R.E. members to achieve our common objectives. Former Secretary of Agriculture, Bob Bergland, who is now the Executive Vice President of the National Rural Electric Cooperative Association, serves as convenor of the C.U.R.E. Coalition. The Coalition is composed of a wide range of governmental groups such as the United States Conference of Mayors, the National Association of Regulatory Utility Commissioners and the National Association of State Utility Consumer Advocates; consumer groups such as the Consumer Federation of America; labor unions, such as the United Auto Workers and the United Steelworkers of America; all three utility associations, including the Edison Electric Institute, which represents the investor owned utilities, the American Public Power Association, which represents publicly owned utilities, and the National Rural Electric Cooperative Association, which represents rural cooperatives and generation and transmission companies; coal associations, including the National Coal Association and the Mining and Reclamation Council of America; agricultural groups, such as the National Farmers Union, the American Bakers Association and the National Council of Farmer Cooperatives; as well as a number of other groups and associations.

Each of the C.U.R.E. members and C.U.R.E. Coalition members, while diverse in nature, share a common concern about the ICC's failure to implement properly the provisions of the Staggers Act relating to captive shippers and consumers. Where the transportation of coal to utilities is involved, our electricity consumers pay the railroad haulage rates.

For utilities, railroad coal haulage costs are reflected in our rates for electric service. Public service commissions do not allow utilities to make a profit on coal costs or the cost of railroad haulage nor to keep any reductions in railroad haulage rates that we are able to achieve. The publicly owned utilities, rural electric cooperatives and investor owned utilities are involved in the Staggers Act on behalf of our electric customers. Every dollar of our railroad coal haulage cost is reflected in our customers' electric bills.

THE C.U.R.E. POSITION

We believe that when Congress enacted the Staggers Rail Act of 1980, it sought to achieve several goals. First, Congress sought to assist the railroads to achieve financial health by removing unnecessary and outmoded rail regulation. Thus, where effective competition exists, railroad rates were to be deregulated. This deregulation, which began under the Railroad Revitalization and Regulatory Reform Act of 1976, was extended to the authorization of contracts between shippers and the railroads and the complete deregulation of railroad haulage that is subject to such contracts. But Congress also recognized the potential problem resulting from the railroads' exercise of unrestrained monopoly pricing power. Thus, a second goal was to protect "captive shippers"—those shippers without alternatives to transportation by one railroad—from "unreasonable" rates. The Interstate Commerce Commission (ICC) was given the responsibility to assure that the rates paid by such shippers are not "unreasonable." The third goal was to assure for shippers competition among railroads. Normally, competition among railroads is achieved through arrangements between railroads called joint rate agreements, reciprocal switching agreements and use of terminal facility agreements. Collectively, these agreements are often referred to as "competitive access" arrangements. The ICC was given discretionary authority, under certain conditions, to assure that such agreements were entered into or maintained at reasonable rates.

We believe strongly that while the ICC has worked hard to achieve the goal of improved railroad financial health, the ICC has done little to achieve the goals of protecting captive shippers and assuring competition among railroads.

Last year, approximately one year after extensive oversight hearings on the question of whether the goals of the Staggers Act were being met, Chairman Danforth introduced Senate Joint Resolution 331, which was cosponsored by nine Senators, including five of the present members of this Committee. Both the text of the Resolution and Senator Danforth's introductory remarks made clear his concern about the ICC's record in protecting captive shippers and preserving competition among railroads. As Chairman Danforth said in his introductory statement, the Resolution "gives a clear signal to the ICC and others that we in Congress really do expect all of the goals of the Staggers Act to be met."

The Resolution then addressed the four major issues that are addressed in the Consumer Rail Equity Act: the ICC's revenue adequacy test; the ICC's market dominance test; the ICC's rate reasonableness test; and the ICC's exercise of its authority to assure competition among railroads.

What has the ICC done in the year since the resolution's introduction? The ICC has changed its market dominance test as suggested in the Danforth Resolution (by oral decision on July 31, 1985), made only minor and unacceptable changes to the rate reasonableness test, refused to take any action on its revenue adequacy test and actually appears to have regressed in the area of the "competitive access" issues.

The net result of the Commission's actions and inactions in the past year is that captive shippers are still without protection against unreasonable rates and that the Commission still does not act to assure competition among railroads. *Employing the principles that it adopted to implement the Staggers Act, no railroad is considered to be revenue adequate and the Commission has yet to order any captive shipper rate to be reduced.*[1] Thus, the members of C.U.R.E. and the C.U.R.E. Coalition now turn to Congress because we are convinced, on the basis of the ICC's rules, regulations and decisions in individual cases, that the system at the ICC that the Staggers Act contemplated for assuring reasonable captive shipper rates and competition among railroads can only be secured by further Congressional action.

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[1] In a letter dated October 16, 1985, to Chairman Philip R. Sharp of the Subcommittee on Fossil and Synthetic Fuels, House Committee on Energy and Commerce, President William H. Dempsey of the Association of American Railroads submitted a list of three cases in which he suggested the ICC had ordered a captive shipper rate to be reduced because it was unreasonable. Two of these cases, Docket No. 37276, *Coal, Wyoming to Redfield, AR*, and Docket 37409, *Aggregate Volume Rate on Coal, Acco, UT to Moapa, NV*, were filed before the Staggers Act and decided shortly after passage of the Act under pre-Staggers Act principles. In a November 27, 1984 letter to Honorable Nick J. Rahall, II, Beryl Gordon, Associate Director of Governmental Affairs at the ICC, stated that both of these cases were decided on the basis of "outdated market dominance and rate reasonableness standards." Moreover, both bases are included in the Commission's order served October 3, 1985, reopening pending coal cases for reconsideration according to the recently announced *Coal Rate Guidelines* in Ex. Parte No. 347 (Sub. No. 1). Thus, while in the *Redfield* case, the rate was effectively reduced by 12 cents per ton for a period of approximately 17 months (until the jurisdictional threshold was increased by the ICC), that was based on pre-Staggers Act principles, and complainants must now prove their case based on the *Coal Rate Guidelines*.

The third case cited by Mr. Dempsey, Docket 38566, *Rates on Iron Ore to Escanaba, MI*, was not a rate reasonableness case, but rather concerned a contract which the railroad attempted to disavow by filing tariffs at higher rates. The Commission found that the contract was binding and disallowed two of the tariff rates, but allowed the railroad to reject the third contract rate on the ground that the rate was too low and it would be "contrary to the Staggers Act" to hold the railroad to its negotiated contract rate. Thus, all the Commission did was to hold the railroad to two of its contract rates, but allow an *increase* in the third contract rate.

Before discussing specific problems with the ICC's implementation of the Staggers Act and the proposed legislative solutions that we support, a few examples of the impacts of the present implementation of the Act might be useful.

EXAMPLES OF CAPTIVE SHIPPER IMPACTS

Let me describe briefly the experiences of three utilities. At Potomac Electric Power Company, over 90% of the electricity we generate for our customers is fueled by coal. Each of our coal fired generating facilities is captive to a single railroad for the delivery of our coal. From 1979 to 1984, our coal haulage rates increased approximately 80%. During this same period of time, general inflation increased only 43% but our electric rates increased only 32.6%. Approximately 30% of our coal cost is railroad haulage. Two of our complaints against our railroad carriers have been pending at the ICC since 1980. Neither have been decided by the Commission.

The experiences of the Kansas City Power & Light Company (KCPL) are also illustrative of the difficulties being experienced by captive rail shippers since the enactment of the Staggers Rail Act in 1980. Most of KCPL's electric generation is provided by four coal fired power plants, each of which, until recently, was dependent upon a single railroad for the delivery of its coal supply.

In an effort to protect its customers against escalating rail transportation rates, KCPL filed with the Interstate Commerce Commission a complaint against rail rates being charged to deliver Powder River Basin coal to the KCPL Iatan Station. The rail rates for delivering coal to Iatan have risen 47%, or almost $11 million on an annual basis, since the enactment of the Staggers Act. This 47% increase in rail rates was imposed over a period of time when the Rail Cost Adjustment Factor—calculated by the ICC to measure increases in rail *costs*—increased only 27%. Thus, the rail rate increase to KCPL was 73% greater than the rate of railroad cost increases, as indicated in the Rail Cost Adjustment Factor.[2] The ICC determined the rate to be "reasonable" by asserting that the carrier involved—the Burlington Northern—had not yet achieved revenue adequacy.

Recent KCPL economic studies have shown that the construction of a new $28 million rail bridge would produce significant savings for KCPL customers simply by allowing for the first time rail competition for the Iatan Station. KCPL recently has begun to enjoy rail competition at one of its previously captive plants. As a result of this competition, the line haul rates quoted to the non-captive Hawthorn plant are some 20% lower than the rail rates quoted to the captive Iatan Station even though the Hawthorn plant is some 60 miles more distant than Iatan from the coal source. KCPL estimates that shipper captivity at Iatan is costing KCPL customers some $4 to $6 million per year.

Iowa-Illinois Gas and Electric Company generates 59% of its electricity from coal fired generation facilities, each of which receives coal exclusively by rail and all of it from mines served by a single railroad. The company's largest plant, the Louisa Generating Station, which is located in Southwestern Iowa, is a captive plant that went into operation in 1982. In 1984, the plant used 930,000 tons of coal that was mined in the Powder River Basin of Wyoming and was shipped to Iowa via the Burlington Northern and the Milwaukee Road railroads. From 1982 to 1984, the cost of transporting the coal increased 12%, but the minemouth price decreased 35% during the same period. At a second captive plant, the Riverside Generating Station, Iowa-Illinois reports that their minemouth coal prices rose 23% from 1980-1984, while their haulage rates to the Burlington Northern rose 50% during the same period.

Mr. Chairman, we in the utility industry are the first to admit that a rate increase in and of itself does not tell the whole story. The reasonableness of a rate can only be determined in relationship to the costs of the service provided.

The vast majority of coal transported by rail moves in highly efficient unit train or trainload shipments. Also, utility shippers are providing more equipment, thereby reducing the railroads' costs. As of the end of 1983, utilities owned more than 33,000 coal cars, a tenfold increase in the last 10 years, and have made substantial investments in terminal facilities.

Recent productivity increases in the railroad industry also have affected the cost to the railroads of moving coal. According to the Executive Vice President of the

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[2] The Rail Cost Adjustment Factor is calculated by the ICC based on data provided by the Association of American Railroads (AAR) and actually reflects changes in the *prices* railroads pay for goods and services, not the changes in the actual *costs* incurred by the railroads.

Association of American Railroads (AAR), the railroads moved 914 billion ton miles of traffic in 1984, about the same amount as in 1980. But, they used 11% less equipment, 11% fewer cars, and 12% fewer locomotives. They also employed 31% fewer workers.

Recently, the Edison Electric Institute (EEI) had the occasion to analyze the profitability inherent in the tariffs of 19 specific captive utilities. The analysis was made when a recent DOE study of railroad rates failed to determine the profitability of the rates in the eight case studies selected by the DOE. The EEI analysis used standard ICC methodology for determining and allocating costs and data provided to the ICC by these companies in their rate complaints. The analysis accounted for unit train efficiencies experienced in those haulages. The analysis showed that the pre-tax returns on investment by the railroads inherent in these coal tariffs ranged from a low of 51% to a high of 157%—the latter for one of my company's own tariffs. (See the Table included as Attachment 3.)

If there are any remaining doubts about the excesses of unrestrained monopoly pricing power, they should be dispelled by the story of what happened to rail rates when competition finally reached the lower part of the Powder River Basin in Wyoming. After the Chicago & North Western (C&NW) Railroad was allowed to enter the lower part of the Basin to compete with the Burlington Northern (BN), coal haulage rates fell dramatically. Earlier this year, both carriers submitted bids to the City of San Antonio and the C&NW won. It is interesting to note that the bid of the BN, the existing carrier, was 17% below the rate it was then charging the City of San Antonio.[3] The C&NW won with an effective bid of only $19.60 per ton, a reduction of $8.06 per ton (29%) over the rate of $27.66 then being charged by the BN. The amount saved on the winning bid—$8.06 per ton—is more than San Antonio is paying for its coal at the minemouth.

But, coal is by no means the only commodity that has been subjected to excessive rates.

In June of this year, the potato growers of Southern California—who have been exempt from regulation by the ICC, but are, nevertheless, captive shippers—found their rail freight rates skyrocket to unprecedented levels at harvest time. The price of shipping a boxcar load of potatoes to the East Coast markets rose almost 70% in a three week period to a level near $10,000. According to press accounts, the potato growers of Southern California were priced out of their market and had to allow part of their potato harvest to rot in the ground.

The potato grower's plight is brought into even sharper focus by a petition recently filed by Conrail at the Commission. A handler of potatoes based in New York City, G&T Terminal Packaging Company, brought suit against Conrail in the courts, no doubt reasoning that since potatoes are entirely exempt from regulation, it would have no remedy at the Commission. Conrail petitioned the Commission on September 27, 1985, for a declaratory order holding that G&T—or any other aggrieved shipper of exempt commodities—has no remedy in the courts. (Docket 40045). If issued, this declaratory order will leave shippers of exempt commodities without any remedy for unjust railroad actions—not in the courts, based on the declaratory order, and not at the Commission, based on the exemption itself.

Another commodity that is subject to rail rate abuse is grain. In 1980, a group of Montana grain farmers filed a class action suit against Burlington Northern in the U.S. District Court there, challenging rates charged for moving wheat from Montana to Oregon. The District Court referred the case to the ICC which has yet—after five years—to make a final decision in the case. This case is particularly outrageous because in 1981, an ICC Administrative Law Judge found that the farmers were paying rates with a revenue to variable cost ratio of almost 300% and that a 200% ratio was the maximum reasonable rate to be charged. (The jurisdictional threshold in the Staggers Act for captive shippers is a 180% revenue to variable cost ratio.) The ICC has held this ruling in limbo while it tried to decide what test should be applied in determining rate reasonableness. In the meantime, the farmers continue to pay excessive rail rates for grain shipments.

The Colorado Wheat Administrative Committee has reported that the marketing of Colorado grain is being hindered by excessive rail switching charges. Colorado grain shippers wishing to ship their commodity to Kansas City, California, gulf ports and Pacific Northwest port markets, are faced with switching charges ranging from $300 to $400 per car. This charge, reportedly the highest switching charge of

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[3] San Antonio's repeated attempts to obtain relief at the ICC from these excessive captive shipper rates have thus far been unsuccessful.

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any major grain market in the nation, compares to a $100 per car switching charge that is considered average in most terminal markets.

Last year, Amax Chemical Company had to close a phosphate mine in Florida when the Seaboard Railroad imposed a 100% rate increase over a three month period on hauling phosphate rock for a 62 mile run from the mine to a processing plant.

Even the United States Department of Energy (DOE) has felt the impact of unrestrained monopoly pricing power. It has attempted to challenge rates for the shipment of spent nuclear fuel where the revenue to variable cost ratios range from 871% to 1,221%. After being before the ICC since 1981, the DOE has yet to win a final ruling that these rates are unreasonable. To do so, it may have show that the rates exceed the cost of building a new railroad to ship the spent fuel, as provided in the new coal rate guidelines adopted on September 3, 1985.[4]

SPECIFIC PROBLEMS WITH THE IMPLEMENTATION OF THE STAGGERS ACT

By rule, regulation and decisions in individual cases, the ICC has made it almost impossible for captive shippers to challenge unreasonable rates. It is not surprising that, employing the principles adopted to implement the Staggers Act, the ICC has not issued a single final decision ordering a captive shipper rate to be reduced.

Its own administrative law judges have publicly recognized this situation. In a 1983 proceeding, one judge concluded that: " . . . the Commission, at the present stage of its death throes does not intend, as can be seen from both its actions and inactions, to find a rail rate, no matter how high, to be above a maximum reasonable level."

A brief survey of the procedures for challenging rates at the ICC shows a system which offers little hope for captive shippers. Under the Staggers Act, prior ICC approval of rail rates is not required. The railroad simply establishes the rate by filing a tariff rate for the shipper in question. If the shipper believes the rate is excessive, the shipper must petition the ICC for relief.

The shipper cannot challenge the reasonableness of a rate unless it first proves that it is a "captive shipper" under the Staggers Act by proving that (1) the proposed rate exceeds the statutory jurisdictional threshold (now 180% revenue to variable cost) and (2) it is subject to railroad "market dominance." Market dominance means that the shipper has not effective alternative to shipping the commodity in question by a single railroad.

Having proven that it qualifies as a captive shipper, the shipper—not the railroad—must then prove that the challenged rate is "unreasonable." This constitutes an almost impossible burden of proof for a shipper for two reasons: the ICC's standards for determining the revenue adequacy of the railroads, and its test for rate reasonableness.

REVENUE ADEQUACY

The ICC's findings concerning the "revenue adequacy" of railroads are crucial for captive shippers. If a railroad is found not to be revenue adequate, the ICC grants that railroad greater flexibility in setting rates for captive shippers.

Unfortunately, the ICC has adopted a totally unrealistic revenue adequacy test under which no railroad is considered to be revenue adequate. The ICC revenue adequacy standards understate railroad financial health by substantially overstating both railroad investment base and cost of capital.

In essence, the methodology for measuring railroad financial health, as defined by the ICC, is unique and not consistent with practices generally applied by other utility regulatory commissions. The National Association of Regulatory Utility Commissioners (NARUC) shares this view. As stated in the resolution adopted by the National Association of Regulatory Utility Commissioners in March 1984: [The ICC defines] "revenue adequacy, on which several pricing freedoms for railroads under the Staggers Act are based, unrealistically, so that no Class I railroads, no matter how profitable, are considered to have adequate revenues, and highly profitable railroads will be allowed billions of dollars in extra rate increases."

The ICC substantially increases railroad revenue adequacy requirements in a number of ways. For example, in making its revenue adequacy determinations, the ICC:

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[4] *United States Department of Energy* v. *Aberdeen & Rockfish R.R.* Docket 38302, order served May 15, 1984 in Docket 37891.

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Includes the current cost of debt rather than the generally lower embedded cost of debt which the railroads actually pay;

Permits the railroads to earn a return on deferred taxes as part of their investment base. Although these funds are acquired without cost to the railroads, they are treated as though costs were incurred to be reflected in rates. The result is that railroad revenue adequacy requirements are increased;

Determines railroad debt-equity ratios on the basis of current market rather than actually incurred costs and makes no judgment as to the appropriate prudency of the railroads' capital structure; and

Fails, by its own admission, to include all railroad related investments, revenues and expenses in the determination.

If practices generally applied by utility regulatory commissions were applied, a far more realistic view of the railroads' economic health would emerge. Under the current ICC standards, these railroads will continue to fall far short of revenue adequacy for years to come.[5] In addition, the rulemakings pending at the ICC would only make the revenue adequacy test worse by calculating a railroad's investment base on the basis of current costs (which could be either reproduction or replacement costs).

The Danforth Resolution directed the ICC to adopt a more realistic revenue adequacy test. The ICC has refused to take any action on its revenue adequacy test.

RATE REASONABLENESS TEST

In evaluating the ICC test for judging the reasonableness of a challenged rate, the analysis must focus on the ICC's coal rate guidelines. These guidelines, which were finally issued on September 3, 1985, represent the only systematic effort by the ICC to establish any kind of rate reasonableness test and, if the ICC's own preliminary orders are any indication, will undoubtedly be applied to other commodities besides coal.[6]

The Coal Rate Guidelines provide three alternative "constraints" for captive coal rates.[7] Under all three, the capitive shipper has the burden of proof.[8]

First, if the railroad is revenue adequate, the coal transportation rate is constrained in some unspecified fashion. However, in light of the ICC's failure to reform its revenue adequacy test, this type of constraint has little significance. This is particularly true since the ICC has indicated that this constraint—which is not defined—will apply only after the rail carrier has been revenue adequate for several years.[9]

Second, according to the ICC, proof that a carrier's revenue inadequacy is due entirely to management inefficiency will constrain the rate. This test imposes an unprecedented burden of proof on the shipper, especially in light of the magnitude of overstatement of revenue need built into the ICC's current revenue adequacy test. Thus, even if the ICC keeps its promise to allow adequate discovery to the shipper, this will remain a virtually impossible option for proving a rate to be unreasonable.

Third, the new guidelines retain "stand alone cost" as an upper limit on rates. Stand alone cost is the cost to a shipper or group of shippers of building and operating their own railroad at today's prices. In other words, if a shipper thinks the quoted rate is unreasonably high, the ICC requires the shipper to demonstrate the

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[5] In the words of one of the Commission's own Administrative Law Judges, "Using the present method of arriving at a finding as to which carriers are revenue adequate it will be difficult if not impossible for any carrier to be considered revenue adequate." *Consumers Power Company* v. *Norfolk & Western Ry. Co.*, No. 37854S, decision served 1/18/84, at 9.

[6] These commodities include aluminum (*Anaconda* v. *Burlington Northern*, Docket 37550 and other cases), wheat and barley (*McCarty Farms* v. *Burlington Northern*, Docket 37809), phosphates (*Mobil Chemical* v. *Seaboard Coast Line*, Docket 37583 and other cases), soda ash (*Allied Chemical* v. *Ann Arbor*, Docket 38412S), sugar (*Amstar* v. *Alabama Great Southern*, Docket 38239), corn syrup (*Amstar* v. *Atchison, Topeka & Santa Fe*, Docket 37478), clay (*International Minerals & Chemicals* v. *Burlington Northern*, Docket 38[illegible]84), pulpwood and wood chips (*Consolidated Papers* v. *Chicago & North Western*, Docket 37626), magnesium ingots (*Aluminum Co. of America* v. *Burlington Northern*, Docket 37699), and spent nuclear fuel (*United States Department of Energy* v. *Aberdeen & Rockfish*, Docket 38376 and other cases).

[7] A fourth "constraint," phasing, is only very briefly discussed in the written decision. Even if a rate is found reasonable according to the three other constraints, the Commission says it could still "phase in" the rate to avoid undue disruption. No guidance is offered on how this case-by-case decision will be made.

[8] *Ex Parte No.* 347 (Sub. No. 1), at 32.

[9] The Coal Rate Guidelines adopted by the ICC on September 3, 1985 state that "revenue adequacy is a long-term concept that calls for a company, over time, to average a return on investment equal to its cost of capital." (*Ex Parte No.* 347 (Sub. No. 1), at 18 (emphasis in original).)

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cost to build and operate a substitute transportation facility at current prices. While the Commission appears to have clarified some ambiguities in its initial proposal, many important questions concerning the application and implementation of the stand alone cost constraint are left unanswered.

No matter how these questions are resolved, however, two things are clear. First, only a very few shippers will ever be able to afford to attempt the application of stand alone cost. Second, even for those few who can afford it, only those who are moving tremendous volumes of traffic over densely traveled rail corridors will have any hope of success. In short, the Commission's final coal rate guidelines do not constitute a fair and workable standard of rate reasonableness for captive coal traffic or for any other commodity.

The Danforth Resolution directed the ICC to clarify its proposed rate reasonableness test for coal and to remove the 15% annual rate increase aspect of that proposal. Senator Danforth's introductory remarks, and the preamble to the Resolution, both make it clear that by "clarification", the Resolution meant a constraint on the railroads' ability to escalate rates charged to captive shippers. The Commission has removed the 15% annual rate increase provision, but replaced it with a case-by-case method of determining the appropriateness of annual rate increases to captive shippers. We believe that the Commission has not adequately "clarified" the coal rate reasonableness test, has not imposed a meaningful constraint on railroad rates and has finally adopted a test which the Commission itself admits is unique among American regulatory standards.[10]

It is worth mentioning here that in a series of decisions the Commission has all but written out of the law the so-called "Long-Cannon factors." These factors, which were the product of a delicately negotiated compromise during Senate consideration of what became the Staggers Act, were intended to assure that captive shippers do not pay for railroad inefficiencies. However, the Commission has declined to issue rules to implement the factors, crippled the ability of shippers to obtain meaningful discovery, and suggested—as it did in its *Coal Rate Guidelines*—that the shipper would have to show that inefficiences were responsible for all of a railroad's revenue shortfall before a rate would be reduced.[11]

In addition to bearing the burden of proving that it is a captive shipper and, thus, is eligible to have its case heard by the ICC, the captive shipper must also bear the burden of proving the rate is "unreasonable." The railroad possessing monopoly pricing power over the captive shipper escapes any responsibility for justifying its rate. Various Administrative Law Judges at the ICC have commented on the immense burden of proof on captive shippers. For example:

> [I]t appears to this Administrative Law Judge that the complainants are wasting an enormous amount of time, energy and money, proceeding with these cases before a Commission that has clearly shown that it is unable or unwilling to find a complained of rail rate to be above a maximum reasonable level where a carrier is not revenue adequate.[12]

> The amount of detail collected, examined and analyzed by [the complainant] passes belief and total understanding. However, complainant has no other choice unless it is to blindly accept the cost conclusions projected by Conrail. * * * In this regard, [the complainant] made a good faith and extraordinary effort to obtain complete data [on stand-alone costs], but failed because of the enormity of the task.[13]

We believe the burdens of proof must be shared between the railroads, and the captive shipper. The railroad must prove that its rate is "reasonable" if a shipper is found to be captive.

MAXIMIZING COMPETITION AMONG THE RAILROADS

Often, a rail shipper's only opportunity for obtaining competition is when railroads will enter joint rate agreements, switching agreements and use of terminal facility agreements at reasonable rates. these historical arrangements between railroads allow efficient routing and movement from one rail system to another where rates or service may be more attractive. Under certain circumstances, the ICC has the power to force the railroads to enter or maintain such arrangements at reasonable rates. Many shippers have alleged that since the enactment of the Staggers Act, the railroads have refused to enter such arrangements, canceled such agreements or drastically increased their fees for such arrangements, all with the purpose of reducing competition and increasing their universe of captive shippers.

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[10] *Ex Parte No.* 347 (Sub. No. 1) at 30.

[11] *Arkansas Power & Light Co.*, 365 ICC 983 (1972); *Dayton Power & Light Co.* v. *L&N*, 367 ICC 366 (1983); *Petition of Louisville & Nashville R. Co.*, Docket 38946, decisions served November 24, 1982 and June 23, 1983.

[12] *Consumers Power Company* v. *Missouri Pacific R. Co.*, No. 37853S, decision served January 18, 1984 at 8 (emphasis supplied).

[13] *Pennsylvania Power & Light Company* v. *Conrail*, No. 38185S, decision served July 18, 1984, at 6, 9.

The Danforth Resolution directed the ICC to examine these practices and assure that the railroads were not acting to avoid competition. Early in 1985, the Association of American Railroads (AAR) and the National Industrial Transportation League (NIT League) reached an agreement concerning these "competitive access" arrangements and asked the ICC to implement the agreement as a rule. The agreement established the procedures and circumstances under which the Commission would order or maintain competitive access arrangements. The agreement was premised on the Commission's then existing interpretation of the statutory showing that was required for relief under the Staggers Act competitive access provisions.

The AAR/NIT League agreement was pending before the Commission throughout this year. On September 11, 1985, the ICC agreed to issue the AAR/NIT League agreement as a rule (a written decision has not yet been issued). Unfortunately, however, on July 17, 1985, the Commission had issued a decision in *Midtec Paper Corporation* v. *Chicago & North Western Transportation Company,* which substantially increased the statutory showing needed to obtain relief under the Staggers Act competitive access provisions. According to NIT League legal documents, the *Midtec* case "largely cancel[s] out" its compromise with the AAR.[14]

According to Chairman Taylor's dissent,[15] this decision renders "these shipper protective provisions totally meaningless," and undermines the AAR/NIT League agreement on procedures to be followed in competitive access cases. On October 10th, testifying before the House Judiciary Committee, Chairman Taylor stated that the ICC staff has recommended that the Commission seek the return of the case from the Court of Appeals for reconsideration. The Commission has not announced any action on this staff recommendation.

Thus, the Commission has actually made it more difficult to obtain relief from anti-competitive practices by substantially increasing the statutory showing needed to obtain relief from the Commission.

THE CONSUMER RAIL EQUITY ACT

Mr. Chairman, the Consumer Rail Equity Act is a modest, mid-course adjustment in the operation and implementation of the Staggers Act. It reaffirms the balance carefully struck in 1980 among the needs of large and small railroads, shippers, receivers and consumers. It preserves the deregulation of competitive traffic; the authority to enter railroad transportation contracts; deregulation of such contracts; and the jurisdictional thresholds established in the Act.

In recent weeks, the Senate cosponsors of the Consumer Rail Equity Act, S. 477, which is pending before this Subcommittee, have reviewed this legislation. An effort has been made to revise and simplify S. 477 in light of changing circumstances. These revisions have now been incorporated in an amendment in the nature of a substitute that was introduced in the Senate yesterday by Senators Andrews, Long, Ford, Stevens, Exon, Rockefeller, Gore and the other seven cosponsors of S. 477.

The major elements of the amended bill are as follows:

1. It changes the present ICC standard for determining revenue adequacy. The amended bill would apply the generally accepted regulatory commission practices for establishing the investment base and cost of capital, eliminating other tests in S. 477.
2. it requires the ICC to adopt a new rate reasonableness test that does not rely on "stand alone cost" to measure the reasonableness of the rate. (S. 477, as originally introduced, specified the rate reasonableness test to be used by the ICC.)
3. It appropriately shifts to the railroads the burden of showing the reasonableness of the rates which captive shippers challenge at the ICC.
4. It codifies the July 31, 1985 ICC decision modifying the definition of "market dominance" in accordance with the provisions of the Danforth Resolution.
5. It requires the ICC to order or maintain joint rates, the use of terminal facilities and switching agreements where such orders are in the public interest or necessary to provide competitive rail service.

The net effect of these provisions, Mr. Chairman, is to change the implementation of, not the substance of, the Staggers Act.

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[14] Motion to Intervene, filed August 15, 1985. *Midtec Paper Corporation* v. *ICC,* (D.C. Circuit).

[15] Chairman Taylor, dissenting, served August 7, 1985 at 10.

It should be emphasized that the Consumer Rail Equity Act retains the present statutory threshold for ICC jurisdiction over rail rates. It maintains the deregulation of all rates that are deregulated under present law. This means that captive shippers can only challenge rates which exceed a 180% revenue to variable cost ratio,[16] just as under present law.

While the members of C.U.R.E. and the C.U.R.E. Coalition accept differential pricing, we cannot accept bizarre standards, unduly burdensome tests and unfair procedures at the ICC. Congress never intended that the exercise of monopoly power by the railroads—both with respect to pricing and competitive access decisions—should be uncontrolled, but that has been the effect of the ICC's implementation of the Staggers Act.

On behalf of Consumers United for Rail Equity and the members of the C.U.R.E. Coalition, I urge the Committee to schedule legislative hearings on the Consumer Rail Equity Act and to move expeditiously to mark-up of the legislation.

Thank you, Mr. Chairman.

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[16] Under 49 U.S.C. § 10731, which governs rates charged for transportation of recyclable or recycled commodities, the Commission annually sets a revenue to variable cost ratio which, if charged to all traffic, would cover all of the railroads' costs, including depreciation and obsolescence, plus a reasonable return on capital that would render the railroads revenue adequate. This revenue to variable cost ratio has to date always been determined to be in the range of 150%. Thus, the Staggers Act contemplates that the railroads are free to price differentially from the 150% recyclables determination up to the 180% jurisdictional threshold.

Attachment 3

UTILITIES INCLUDED IN DRAFT DOE STUDY
Pre-Tax Return on Investment (ROI)

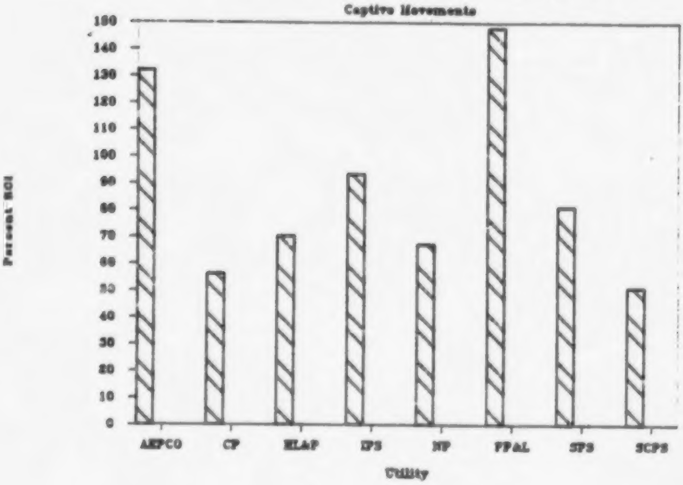

TABLE 1

Estimated Pre-Tax Return on Railroad Investment Used to Provide Service to Utilities with Captive Coal Movements (1984): 8 Utilities Included in the Draft Department of Energy Study

Utility	Railroad	Pre-tax Return on Investment Used in Captive Utility Coal Movement
Arizona Elec. Power Co-Op	Santa Fe	132%
Consumers Power	C&O	56%
Houston Lighting & Power	BN	70%
Iowa Public Service	BN	93%
Nevada Power	UP	67%
Pennsylvania Power & Light	Conrail	148%
Southwestern Public Service	BN	81%
South Carolina Public Service Authority	Seaboard	51%

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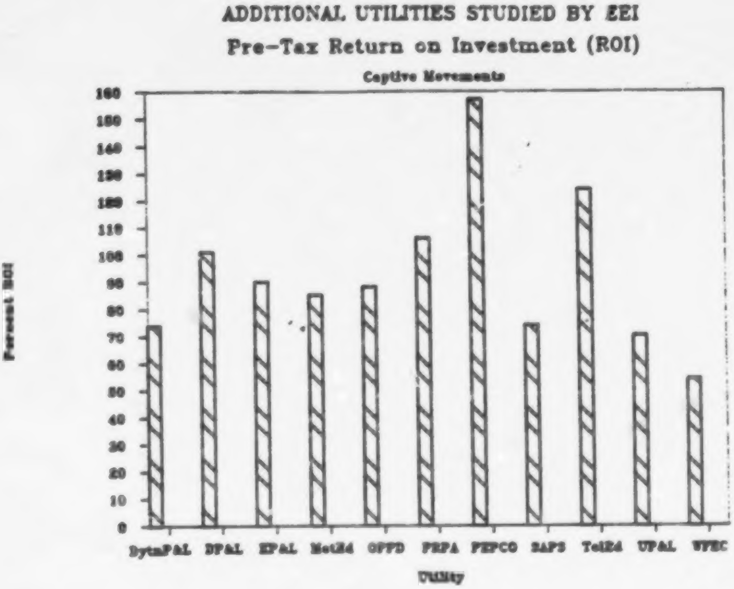

TABLE 2

Estimated Pre-Tax Return on Railroad Investment Used to Provide Service to Utilities With Captive Coal Movements (1984): 11 Additional Utilities

Utility	Railroad	Pre-Tax Return On Investment Used in Captive Utility Coal Movement
Dayton Power & Light	Seaboard	74%
Delmarva Power & Light	Conrail	101%
Kansas Power & Light	UP	90%
Metropolitan Edison	Conrail	85%
Omaha Public Power Authority	BN	88%
Platte River Power Authority	BN	106%
Potomac Electric Power Company	B&O	157%
San Antonio (City of)	BN	74%
Toledo Edison	N&W	124%
Utah Power & Light	Denver Rio Grande	70%
Western Farmers Elec. Co-Op	BN	54%

The **Chairman**. Thank you, Mr. Mitchell.

Mr. Melville.

Mr. **Melville**. Mr. Chairman, Senator Long, my name is Bill Melville. I am director of purchasing and transportation for Kennecott in Salt Lake City, and next to me on my left is John Archer, who is director of logistics for Crown Zellerbach in San Francisco. We are cochairmen of CARS, the Committee Against Revising Staggers.

We thank you for the invitation to be here today. CARS started early this year with a couple of hundred members and is now grown to over 320. So in less than a year from inception, we have had a 50-percent increase. Our members include shippers of virtually all commodities, including chemicals, coal, grain, and manufactured products.

We range from the largest corporations to the smallest railroad shippers and are widely dispersed throughout the country. Incidentally, we only have 11 members from New York.

The vast majority of our members are small companies. Less than 20 percent of the membership consists of large multistate shippers. A list of the members is attached to our prepared statement.

CARS vigorously supports the Staggers Act and opposes efforts to revise it because it is working well for shippers. It provides market-oriented rates and better, more reliable service from the railroads. It has been a major factor in restoring the financial health of the railroad industry, as it was designed to do.

Five years ago, we were suffering from car shortages, terrible service; it was a nightmare. The price of CARS members' products are set in the marketplace, and negotiations are a normal part of our business practices. This negotiating tool is by far the best way to arrive at reasonable freight rates, even for captive shippers.

Some people do not understand how this can be done. Well, it is not easy. Kennecott is a captive shipper in a number of cases. We have an ore movement in Arizona from the mine to the mill. We move ore in 100-ton cars, 60 cars to a train, and we move 6 trainloads of ore a day on the Southern Pacific. There is no other way to move that product.

We have arm-wrestled with the Southern Pacific over the years and it has not been easy, but we have reached accommodation with them.

We move sulfuric acid from Hurley, NM, into Louisiana, Texas, and as far as Florida. It is a hazardous commodity. There is no way to truck it from New Mexico to Florida. What is our leverage? Well, it varies from case to case. But on acid, we have to sit down and convince the railroads that if we cannot market our acid, the plant will shut down, and we have been able to do that.

The negotiations are not easy, and sometimes take weeks, even months, to finalize. An increasing number of shippers are beginning to realize this, including captive shippers, and are signing long-term contracts with the railroads. As of mid-1985, there were over 25,000 rail contracts in place. In those cases where negotiation just does not work for a captive shipper, there are remedies available before the Commission and the courts.

Shipper groups have reached agreement with the railroads in several areas concerning captive shippers. The ICC has approved the agreements, as we have heard today, and implementation has started.

We believe that the remedies will work but only time will tell. If Staggers is reopened now, the question of total deregulation versus reregulation will be reopened, as well as all the compromises in between.

We ask you, please, don't change the Staggers Act.

[The statement follows:]

Statement of the Committee Against Revising Staggers [CARS]

We are William Melville, Director, Purchasing and Transportation, Kennecott and John Archer, Director Logistics, Crown Zellerbach. We are Co-chairmen of the Committee Against Revising Staggers (CARS) which is a coalition of over 320 rail shippers of all kinds; large and small, bulk and non-bulk commodities, captive and competitive. Our members include shippers of manufactured goods, agricultural products, chemicals, minerals (including coal, copper, and iron ore), pulp and paper, iron and steel materials, and a variety of other commodities. We range from the largest Fortune 500 companies to small, independent businesses and are widely dispersed throughout 50 states. A list of our member companies is attached.

We vigorously support the Staggers Act as passed by Congress in 1980, and oppose efforts to revise it because: Staggers is working well for shippers—providing better service and market-oriented rates; Staggers is assuring shippers reliable future rail service by restoring the rail industry to financial health; and the Staggers Act provides other available avenues for relief which are being and should continue to be fully utilized. These include administrative and judicial proceedings, as well as negotiation of contract rates between shippers and carriers.

I. STAGGERS IS WORKING FOR SHIPPERS

The following statistics demonstrate how Staggers is providing better service and more stable rates for shippers. Competitive piggyback carloadings in 1984 were up 14 percent over 1983, setting a record for the third straight year. Railroad service and efficiency has improved as average freight train loads increased from 2,175 tons in 1980 to 2,543 in 1984. Average freight trains have also increased from 67 cars in 1979, to over 71 cars in 1984. Ton-miles per employee hour in 1984 were up 44 percent over 1980 levels. Equipment is being used more efficiently. Ton-miles per train hour increased by 18 percent between 1980 and 1984, and the ratio of empty car-miles to full car-miles has declined from .828 in 1980 to .756 in 1984. Finally, the long-term decline in railroads's share of intercity freight has reversed itself as railroads have been free to respond to competition from other transportation modes.

Of particular significance to our members is the fact that, since 1980, railroad marketing has become more innovative and customer-related.

II. STAGGERS IS ASSURING SHIPPERS A FINANCIALLY HEALTHY RAIL INDUSTRY TO PROVIDE FUTURE SERVICE

What the C.U.R.E. group and other advocates of rail reregulation fail to recognize, or choose to ignore, is the substantial railroad service improvements and reliability that have resulted from the Staggers Act. Before the act was passed, regulation of railroads under the ICC during the years 1970 to 1979, resulted in 22 percent of the railroad mileage in the U.S. going into trusteeship. The Government had to buy out and combine, at tremendous taxpayer expense, the bankrupt railroads in the Northeast into CONRAIL. In that pre-Staggers period from 1970 to 1979, average rail industry return on investment was 1.9 percent per annum and railroad capital expenditures has exceeded retained earnings in 19 of the past 20 years. Furthermore, large portions of the rail system were badly in need of repair.

At the end of 1978 the ICC reported deferred maintenance of $1.5 billion on Class I railroads, not including CONRAIL. These Class I railroads reported in 1978 that over 43,000 miles of track were under slow order. This not only caused serious delays for shippers but presented a large safety problem as well, especially in view of the large quantity of hazardous materials moved by rail.

In the four years since Staggers, the railroads' return on investment has averaged 4.02 percent as opposed to 2.49 percent in the four years previous to Staggers. Most railroads, including CONRAIL, are now operating profitably—and railroad investment, net in-plant went up from $30.3 billion in 1979 to $45.5 billion in 1984 under the Depreciation Accounting System.

The Staggers Rail Act has greatly helped rail reliability, and for this the large and small shippers that are members of CARS are grateful.

III. THE STAGGERS ACT PROVIDES OTHER AVAILABLE AVENUES WHICH SHOULD BE FULLY UTILIZED

Under the Staggers Act as it currently stands, remedies for shippers are available before the ICC and in court proceedings, as demonstrated by the recent case overturning an ICC decision to exempt coal destined for export. Contracts are available and being used by all kinds of shippers to allow the marketplace to establish reasonable rates. An increasing number of shippers, including those who are on a single railroad, are entering into long-term contracts for their rail movements. As the attached chart from Traffic Management indicates, rail contracts have grown from 660 in 1981 to 25,486 by July of 1985 with 30,000 expected by year end. We understand that over 50 percent of rail coal tonnage movements is today moving under contract rates. According to Railway Age, at least one railroad, the Burlington Northern, has over 75 percent of its 1985 coal tonnage under contract. Negotiation techniques are available—and have worked for shippers in captive as well as competitive situations.

Shipper groups, including the National Industrial Transportation League and the Chemical Manufacturers Association, have reached agreement with the Association of American Railroads on guidelines for competitive access. This agreement was approved by the ICC on September 11 and further negotiations on related issues continue. The American Paper Institute has also reached agreement with the railroads with respect to product and geographic competition. In addition, on September 3, the ICC has issued its final decision in the Coal Rate Guidelines Nationwide for determining the reasonableness of rail captive coal rates. Finally, the Railroad Accounting Principles Board is in full operation and is beginning its work of establishing a rational body of accounting principles which will serve as a guide to implementation of much of the Staggers Act, including revenue adequacy and cost recovery percentage calculations.

In view of the above, the CARS group of shippers feels it is premature for Congress to begin to rewrite the Staggers Rail Act of 1980. The prices of CARS members products are set in the marketplace and negotiations are a normal part of our business practices. The climate of the electric utility industry is quite different and some companies within that industry seem to be having a particularly difficult time adjusting to the deregulated environment. The actions of those utility companies indicate that they prefer that transportation costs be set by the Interstate Commerce Commission rather than being freely negotiated because these utilities think that ICC-set rates are easier to justify before their state public utility commissions.

It is also true that considerably more traffic is captive in the short run than in the long run and we feel that many of the problems encountered during the first few years under the Staggers Act will be substantially reduced as time goes on. In the long run, a purchaser has a number of options as to sources and those options should give him sufficient leverage to negotiate reasonable freight rates. Similarly, a shipper served by a single railroad is not liable to be put out of business due to high freight rates by a railroad which wants to move his product.

We agree wholeheartedly with the conclusion of the May 1985 Department of Energy's Staff Working Draft Report "Effects of Railroad Regulatory Reform on Coal and Electricity" in which it is stated that "the basic finding of this analysis is that the Staggers Act is well conceived, that it is consistent with national policies relating to both energy and transportation, and that its effective and efficient implementation is still developing." (Report, p. 16.) the Department of Energy Report makes a number of thoughtful recommendations which are being considered by the Interstate Commerce Commission as it further refines its rules for implementing the Staggers Act.

IV. THE CURE REREGULATION BILL

From the CURE group of utilities and certain coal companies there have been assertions that the Staggers Rail Act of 1980 needs to be amended. Their position is based on the allegation that so-called "captive" shippers of coal and other commodities are being charged excessively high prices by some railroads.

CARS strongly opposes any attempt to reopen the Staggers Act because such attempts, as amply demonstrated by the CURE-supported S. 477, would involve a massive reregulation of the railroad industry to the substantial detriment of the vast majority of rail shippers and the consumers that we serve.

The CURE-proposed legislation (S. 477) which we strongly oppose, operates under the premise that railroads should be regulated as public utilities. Under these provisions of the CURE bill, there would be an automatic investigation of all rail rates, provided market dominance tests of 180% of variable costs are met. The bill creates a presumption that market dominance exists if a shipper is served by a single rail line unless the rail carriers can prove that effective competition exists from other carriers or modes of transportation and the burden of proof would be shifted to the railroad and the ICC to prove the consistency of rate with the 15 elements of the national rail transportation policy, and with the Long-Cannon factors. In nearly 100 years of ICC regulation of rail rates, there has never been an automatic investigation of individual railroad rates. This is more individual rate regulation than existed even before the passage of the Staggers Act.

Furthermore, these provisions would have the effect of forcing all rates on captive traffic to be at the same level with relation to variable cost. The requirements that rates over 180 percent of variable cost on a movement controlled by a single railroad would be subject to automatic investigation would destroy the wide open negotiations based on market needs which has come to characterize railroad pricing since 1980. These provisions would, CARS believes, lead to a tremendous increase in litigation before the ICC and the courts and stifle the negotiation process which has resulted in so much innovation and increased efficiency over the past few years.

The manner in which rates were regulated prior to the Staggers Act led to the establishment of freight rates without real negotiation. Rates were based on detailed comparisons of existing rates on the same or similar commodities with little or no regard for marketing considerations and the public filing of all rates made it extremely difficult to differentiate based on particular market situations. The inability to maximize the contribution made by captive traffic based on market demand forced the railroads to seek the short run solution of across the board increases. In the long run, however, this drove competitive traffic away, enlarging the burden which had to be borne by the captive traffic and destroying profits. This cycle led to the under-investment in rail facilities and the resultant poor service which became so evident in the 1970's. The contribution of the Staggers Act, we believe, was not in deregulating competitive traffic, which had effectively been deregulated in prior years, but in the freedoms it granted the railroads in pricing captive traffic. Returning to regulation of captive traffic by restricting differential pricing would most likely lead to the same downward cycles in railroad investment and service that we saw ten years ago.

We know from experience the effect of maximum rate level decisions. Prior to deregulation under the Staggers Act, the ICC case decisions on dozens of commodities were the basis for the actual rates. While the decisions set the maximum level, in practice, that became the level for all rates and new movements were automatically given a rate according to the ICC prescribed mileage scale. Potential movements which required a lower rate simply did not take place even if they would have contributed to fixed costs. An efficient railroad system is one that maximizes the traffic base over which it can spread its fixed costs by pricing its services according to demand.

Staggers was a compromise between those who sought to remove all maximum rate regulation after a five-year transition period—in 1985, and those who disagreed with the pre-Staggers Act ICC maximum rate rules and sought broad ICC regulatory protection. If Staggers is reopened at this time, the question of total de-regulation vs re-regulation will be reopened—as well as all the compromises in between.

For these reasons we strongly urge this Subcommittee not to consider reopening the Staggers Rail Act.

This concludes our prepared statement. I would be most pleased to answer any questions you might have.

The CHAIRMAN. Thank you, Mr. Melville.

Senator Long.

Senator LONG. I am interested in what you said, Mr. Melville, that you have a remedy. You can tell a railroad that if it doesn't give you a more reasonable rate, your plant will have to shut down.

I don't think that an electric generating plant has that same option. It seems to me as though it can pass it on to the customer, but I don't think it is fair to pass it on to the customer if it is a matter of abusing a captive customer.

Now, if you are happy about your situation, nobody is proposing to change that. You can just go ahead and live with it, and tell the railroads, look, if you are going to be that rough on us, we will just have to close down and go out of business. It is all right with me if you do business that way, but there are some people who are trying to protect our consumers out there, such as the private investor-owned electric companies.

I don't know why you have to get all upset. Since your company does have control over the railroads, I don't see why your people need get upset if we undertake to make the Staggers Act mean what it was supposed to mean in the first instance. I helped write the bill, at least the part that I am concerned about.

Why does it hurt you if we take a look at the reasonableness of what the ICC is doing for some other captive customer who wants to protect his customers?

Mr. MELVILLE. Well, to answer the first part of your question, Senator, I would think that the utilities must have some other options available to them if they really thought about it. We have found that we, when we are faced with problems since Staggers, that we can sit down and brainstorm and come up with things we never thought of before. And with wheeling of power and with changing from coal to oil to gas, it seems to me that the utilities probably have more flexibility than they may think they have if they really sat down and talked to the railroads about it and hammered it out with them.

For the second part of your question, we are concerned about changing Staggers, because if we do so, anybody that has a freight rate that is over 180 percent of variable cost and is a captive shipper is going to protest to the Commission. We will have a mess at the Commission. I would feel compelled to do it. If my management would ask what level our freight rates were at, and if I said they were over 180 percent, their reply would be why didn't you protest them. We would be right back where we were prior to Staggers.

Senator LONG. What is your reaction to that, Mr. Mitchell?

Mr. MITCHELL. Senator, the thought that utilities have other options is not quite exactly correct. To think that we can take our coal-burning plants right now—after we have so diligently worked to convert to coal or to construct to burn coal and have the coal option, in the interest of national energy policy, in the best interests of this country to keep down the degree of imported oil and the outflow of dollars and reduce the increase of the foreign trade deficit—to say that we can make that conversion to oil, therefore we have options, is just patently absurd. We simply do not have those options.

National laws govern and restrict the use of oil and gas. Our options are few and, in most cases, none.

Senator LONG. Generally speaking, what we would like to do in Louisiana is to get loose from coal, stay loose from coal, and have nothing to do with the commodity. From my point of view, our consumers are being raped down there, and we have natural gas, we have enough of it, we have a surplus, and that is what we want to use. But I am told by those who have built these plants—and pursuant to an act of Congress now, Congress has made them, by Federal law, shut down gas-generated plants and convert to coal—that our consumers are being raped.

Then you say well, now, what can you do about turning around this situation and going back to natural gas? What they tell me is this: That if you want to go back to gas, you cannot convert the plant; it would be cheaper to build a whole new plant than it would be to convert that plant to coal or natural gas.

Is that what you understand?

Mr. Mitchell. That is the case for some types of plants, Senator. Yes, sir.

Senator Long. So that you cannot very well convert them.

Now, I heard Mr. Taylor say here, let me see if I recall—that the railroads are doing very, very well. They are accumulating amounts of cash. And yet in terms of revenue adequacy, we don't think that is adequate. Their privilege then is to go ahead and rape those customers, those captive customers.

Here it is, a railroad which has been able to engage in close to a $2 billion acquisition. However, the ICC doesn't know of any company that is doing so well that it would be regarded as revenue-adequate.

Now, you talk about measuring interest. It seems to me that if they are doing "very, very well indeed," and they are accumulating large amounts of cash, and they can go buy big companies all around the country and outbid everybody on Wall Street to buy more railroads, for example, why must we say that nothing can be done about them charging a very high rate to haul that coal?

Frankly, I think that we are at least indebted to those of you in the private power industry—and if they had been permitted to testify, the same would be true of the publicly owned generating plants, because they feel that they cannot protect their customers but that they have a duty to do so. And I think we are indebted to you for coming up here trying to protect your customers, feeling that they are being overcharged.

They are being overcharged because you are being overcharged. That is your position.

Mr. Mitchell. Yes, sir. And that is true for both public and private utilities, beyond a doubt.

Senator Long. And your people know something about regulation. You have been regulated for your entire existence, have you not—completely regulated?

Mr. Mitchell. Yes, sir, we have.

Senator Long. Well, thank you very much.

The Chairman. Thank you very much. That concludes the hearing.

[Whereupon, at 2:47 p.m., the hearing was adjourned.]

OVERSIGHT OF STAGGERS RAIL ACT OF 1980

MONDAY, NOVEMBER 4, 1985

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room SR-253, Russell Senate Office Building, Hon. Bob Packwood (chairman of the subcommittee) presiding.

Senator **PACKWOOD**. The committee will come to order, please.

Our first witness today is my good friend, the Senator from Idaho, Steve Symms. Steve, if you are ready, we are ready.

STATEMENT OF HON. STEVEN SYMMS, U.S. SENATOR FROM IDAHO

Senator **SYMMS**. Mr. Chairman, thank you very much, and I am pleased to be here with you today to offer some very brief remarks regarding the implementation of the Staggers Rail Act of 1980.

Mr. Chairman, I commend you for holding these oversight hearings to review the effects of partial deregulation in the Nation's railroads. Until the process of deregulation is completed, Congress must closely monitor the economic health of the railroads and the business conditions prevailing between the railroads and the customers who depend on rail transport to ship or receive goods.

I believe we in the Congress have a responsibility to provide some mechanisms by which railroads might maintain their financial stability while providing adequate service at reasonable rates to all shippers, including those who must rely on rail to transport their goods.

A number of industries, and particular shippers around the country are especially vulnerable to the ratemaking power of railroads which do not face competition for services they provide to those industries or shippers. Congress must ensure that the Nation's captive shippers are not ruined financially because of the absence of a proper forum in which to address their complaints against the railroads.

The lumber industry, which is so important to the economies of our States, Mr. Chairman, serves as a good example of the problems faced by many of the Nation's captive shippers. The nature of the product shipped makes this industry heavily dependent on rail transport, and most areas of the country have little, if any, rail competition providing service to these lumber mills.

In northern Idaho, Mr. Chairman, a number of small lumber mill owners have formed a co-op with owners in Washington and

Montana in order to place themselves in a better bargaining position with the Burlington Northern Railroad which serves that area.

Unfortunately, the increased volume of shipments that co-op could support has not resulted in any agreement on a more favorable shipping rate for these co-op members. Furthermore, these members have been frustrated with the ICC's response to the efforts of one member of their group, the owner of Bennett Lumber Products, to obtain a contract between Burlington Northern and a large shipper in the area.

In that particular case, the ICC sent a copy of the contract with all of the rate information necessary to prove rate discrimination deleted. Another problem faced by at least two of the lumber mill owners in north Idaho is rail car discrimination. These companies, Bennett Lumber Products and Idaho Forest Industries, purchased or leased special rail cars to ship their products in the 1970's.

Since that time, both companies have been under pressure to use Burlington Northern cars rather than their own special cars. No agreement has been reached with Burlington Northern regarding the rates paid for the use of these cars. And the companies now are forced to ship their lumber by Union Pacific. Bennett's legal counsel has filed an antitrust suit in which they must show that the railroad used its monopoly power to coerce Bennett to accede to its terms.

Mr. Chairman, I believe these examples illustrate some of the difficulties faced by the small captive shippers who spend a great deal of time and money to file rate discrimination cases only to meet additional difficulties posed by an unresponsive Federal regulatory agency.

I would urge the committee to pursue relief to these shippers in north Idaho and others who may be in a similarly disadvantaged position around the Nation. Either the industry should be deregulated so that the captive shippers can use antitrust laws to provide a safeguard against the railroads' monopolistic powers, or the Congress must act to provide adequate protection for captive shippers through the Interstate Commerce Commission.

And just to summarize, I think that our duty is to ensure that the Staggers Act worked as we envisioned that it would, and there are three major areas where I think we need to readdress what this situation is. The first one, I say again, is the plight of the captive shippers. The Congress recognized in passing the Staggers Act that there would be situations in which there is no competition in rail traffic. Particularly rail traffic subject to monopoly pricing of the railroad should be protected through regulations to be administered by the ICC.

In my view, Mr. Chairman, the ICC is failing to protect some of those captive shippers, specifically some of our lumber shippers.

The secret contracts, point No. 2. The Staggers Act authorized contracts for rail freight transportation. The railroads have taken advantage of the legal concept of confidentiality of contracts to discriminate against small shippers. A contract must be approved by the ICC once written within 18 days. A small shipper who has reason to believe that he has been discriminated against must file a challenge within that time while also meeting burdensome tests proving it has grounds for such a challenge.

This complicated system needs to be simplified. This certainly concerns me, Mr. Chairman, because if we want to get the railroads deregulated so they can become more efficient and clean up their operations and drop unprofitable parts of their service, we have to be very careful that small shippers are not discriminated against. The lack of an adequate response from the railroads will lead us right back down the track of reregulation, and then we will have the Government setting the rates, the time the trains run, and go through the whole process that we have in the past.

So, I think this is a very troublesome thing. It certainly would fail the test of fair trading practices if one shipper is being excessively discriminated against with respect to price. It could put him in a very uncompetitive position in shipping to the east coast, for example, on lumber shipments.

The last one that I want to reemphasize is the regulation of boxcars and private cars. The ICC attempted to deregulate private rail car traffic. The proposed regulations were overturned by the U.S. Court of Appeals, which found that the ICC exceeded its authority under the Staggers Act in deregulating boxcars and private cars.

The Court of Appeals, however, did not issue a writ of mandamus ordering the ICC to proceed under its old rules as the ICC indicated it intended to appeal the decision. In the meantime, private cars and boxcars stand deregulated, and are subject to discriminatory pricing and surcharges by the railroads. It appears to me that the opposite should be the case. It may well be necessary to consider legislation to affirm the Court of Appeals decision upholding the intent of the Staggers Act.

I appreciate, Mr. Chairman, the opportunity to testify here. Mr. Dick Bennett is here in the room, if the committee choose to ask any questions specifically of some of the problems they are having. One problem is their location on the Burlington Northern in Princeton, ID. They now are in a situation where rather than ship on the Burlington Northern, they are loading this lumber on a truck paying $8 a thousand to haul the lumber from Princeton, ID, 60 miles to Clarkston, WA, so it can be loaded on the Union Pacific, and still at a savings to ship it to the same market that could be serviced by both railroads.

Somehow we should be able to do better than that in our free enterprise system to meet those prices and not have congressional interference. I want to indicate to the committee that there are some glaring problems with respect to the captive shippers, specifically in the lumber industry in my State.

I thank you very much for the opportunity to testify here this morning.

Senator PACKWOOD. Senator, I have noticed exactly the same problem with a group in southern Orgon called the Siskiyou Shippers, which is a shipping association formed of what some people might call small mills. They are not really small. They employ from 200 to 500 employees, but they are independently owned mills in southwestern Oregon. They have tried and tried and tried to get contract information from Southern Pacific and others. They have been unsuccessful. And my touchtone as to whether or not I am going to support changes in the Staggers Act is going to be whether or not they are fairly treated in my judgment, and if they are not, I will support the changes necessary to make sure that they are.

Senator SYMMS. Thank you very much.

Senator PACKWOOD. Senator Long.

Senator LONG. Thank you for your statement, Senator Symms. As you indicate in your statement, some of us tried to anticipate the problem of captive shippers and captive customers, and we put language in the bill which could have been used perhaps to solve the problem.

I think the record shows, and when you hear from the captive customers and captive shippers I think you will be pretty much convinced the record shows that the language did not solve it. maybe because the ICC just did not choose to give it the interpretation that we would like to have it give.

But in any event, 5 years is a long time to wait for action along the line we would like to have. Now, I have high regard for Chairman Taylor, but he said I was wrong in saying that the shippers, the captive customers and captive shippers were batting zero while the railroads were batting 1,000.

He undertook to present his case, which when you boil it all down you are left with two cases where the decisions were predicated on language that predated the Staggers Act for complaints that had been pending prior to the Staggers Act.

Now, you know a lot about small business in your experience. How long can a small business last with the kind of discrimination that has victimized the shippers badly?

Senator SYMMS. Not very long. That is the problem, Mr. Chairman. Some of this needs to be settled immediately. When the Staggers Act passed, there was a great deal of concern voiced by shippers in Idaho. The concern actually came from along the Union Pacific route of the potato and onion shippers.

As it has turned out, that has not been the problem, because there is truck competition on those types of shipments, particularly on the fresh produce. But if there is a discriminatory pricing difference of several dollars a thousand on lumber, for example, a small business simply cannot survive that, and I do not think that it is the intention of the railroads or the Congress to end up running small lumber mill operators out of the lumber business. That probably is not the intention of the large companies, but the end result will be that, and I think it is something that needs to be looked at and addressed immediately, or some of these people will simply have to stop shipping.

When we have people who are trucking lumber to another line to ship, then something is haywire. I do not know the answer, but I know that something needs to be done.

Senator LONG. I got the impression that at least some of those railroad executives out there concluded from the Staggers Act and from the way that the Commission had handled the Staggers Act, particularly the complaints, with a 1,000 percent victory for railroads and zero for the captive shippers, that hooray, the old days are back, anything goes, and I think we have to demonstrate to them somehow that that is not the case.

Lacking anything better, I think we are going to have to pass legislation to amend that act. Now, if we amend it as far as I am concerned, all I will be doing is trying to do what I thought I did the first time. I was hoping that the Commission and the courts would construe that language the way I had in mind.

Senator SYMMS. I confirm that, Mr. Chairman. I told some of my staff this morning if they would go back and get the Congressional Record, they would find out when I was a Member of the House I made a statement on this problem on the floor of the House. I supported the Staggers Act, and I am sure the chairman did. But it was our intention to have some protection where a railroad is the only means of transportation for that captive shipper. We intended to provide some arbitration panel to see that fair pricing is actually done in the ratemaking.

Senator LONG. In those situations, for example, where we have water competition paralleling the railroad or when the railroad is not getting any business at all, because of the competition it faces from water and other modes of transportation, it does not bother me at all to see someone come in and say hooray, the Staggers Act is great; do nothing. That is all fine. We did not anticipate any complaints from people in those situations.

What we are concerned about are the complaints that we did anticipate, and unfortunately we are seeing that our fears are being realized. That is where we are trying to change the situation, which we tried to rectify at the beginning. At least we had hoped that the act would be construed so that your complaint would never have had to be made here today.

Senator SYMMS. Well, Mr. Chairman, I might just say one other thing. Companies like the Bennett Lumber Co. and Idaho Forest Industries close down their operations, the people that own them are going to be fine. The problem is that they both employ between 400 and 500 employees, a little less than 500, and those are companies that have been operating in the Panhandle of Idaho for 35, 40 years, and provide a good, solid employment base for literally hundreds of families. Those people will have no place to work.

There here have been pay cuts in these mills. They have had a 5-percent pay cut—actually reduced wages to maintain competition.

If they are losing $10 or $15 or $20 a thousand because of a rate structure which will not allow them to compete with their other colleagues in the lumber business, they simply cannot survive it. Their pocketbooks are not that deep. And the people who will get hurt are the people who work for them. People who own the mills will still own those assets, and they will have timber in the woods, and they can shut down the operation for a few years until times got more favorable. That will not do anything for the job base in our State, and we just cannot afford it.

Senator LONG. Well, the same thing is true on the other hand, down in my area, where we were compelled by law to shift over to coal. Now, the company generating the power by coal does stay in business. They will just have to raise their rates and pass it on through.

However, the customers, including just the ordinary household users, will be penalized very badly. In addition to that, given the State's industrial prospects, we have a lot of people out of work down there, and so we will have plants continuing to shut down where we ought to be opening more, because you cannot compete if your power cost is out of line in other industries.

Thank you very much for your statement.

Senator SYMMS. Thank you very much.

Senator PACKWOOD. Thank you, Steve.

I have a statement from Senator Dole, and I would ask unanimous consent it be placed in the record following Senator Symms' statement.

[The statements follow:]

STATEMENT OF HON. BOB DOLE, U.S. SENATOR FROM KANSAS

Mr. Chairman, let me say at the outset that problems with the Staggers Rail Act of 1980 are ones that have concerned many of us, particularly those of us from rural areas. I especially appreciate the efforts of the distinguished chairman of the subcommittee, Senator Packwood, and the distinguished chairman of the Commerce Committee, Senator Danforth, in scheduling these oversight hearings.

Since the enactment of the Staggers Rail Act of 1980, several problems affecting small grain shippers have been brought to my attention. I respectfully request the committee members to take a close look at these problems in an effort to suggest appropriate remedies.

During the floor debate on the Staggers Act on April 1, 1980, I noted that differences of as much as 2 cents to 5 cents per bushel in contract rates, as compared to tariff rates, could be dangerous to the survival of small elevators. Recently, the United States Department of Agriculture, Office of Transportation, released a study entitled "Impacts on Rail Deregulation on Marketing of Kansas Wheat". That report noted average differences in contract rates as compared to tariff rates of 11 cents per bushel after the enactment of the Staggers Act. Also, during subcommittee field hearings conducted by Senator Kassebaum in Hutchinson, Kansas in September of 1983 there was testimony of one known instance in which a contract range was discounted by 49 percent from the tariff rate of $1.18 per hundred weight to 58 cents per hundred weight for a contract shipper. It seems obvious to me, as well as those responsible for the USDA study, that those who ship grain at a 21 cents per hundred weight price differential will not remain in business much longer.

Congress, in passing the Staggers Act, was clearly concerned that the use of contracts could have an anti-competitive impact on small rural shippers and therefore provided a procedure for a shipper to obtain discovery of a contract that constituted "unjust discrimination" or a "destructive competitive practice". However, I am certain that anyone attempting discovery of a contract under this act will agree that the procedure established by the ICC is difficult at best. Utilizing these discovery procedures, it is nearly impossible to know if a contract is unfair because neither the parties to the contract, the rates paid, nor the specific points of origin, destination, intermediate points, transit points or other shipper facilities to which the contract applies are disclosed in the contract summary. I hope that the committee would take a close look at Interstate Commerce Commission's rules and regulations relating to discovery in an effort to assist the small shippers with their discovery problems.

Another problem area of which I am aware is that the ICC has been allowing "negotiated rate contracts" even though they are illegal and not authorized by the Staggers Act. The act in section 10713(a) authorizes a rail carrier to "enter into a contract under specified rates and conditions." However, the USDA study notes that 42 percent of the contracts filed on Kansas originations to west coast destinations are "negotiated rate" contracts. These contracts provide that the actual rate will be negotiated on a bid and acceptance basis between the railroad and the shipper at the time of the shipment of grain. This effectively deregulates grain altogether from ICC review in direct violation of the statutory language.

It seems to me that the significant disparities between contract rates and tariff rates as documented by the USDA study point out the fact that specific congressional oversight and guidance is required. It is obvious that following the present contractual procedures as allowed by ICC will eventually result in the demise of small grain shippers. I am greatly concered about that, and ask the committee to take appropriate steps to avoid that result. If the only remedy is for the small shipper to prove that he is the victim of "unjust discrimination" or a "destructive competitive practice", we must at a minimum insure that the shipper has access to the necessary information.

Lastly, let me indicate that, working with my staff and the staff of the Commerce Committee, I stand ready to do whatever may be appropriate to resolve the situation. It is my hope that shippers and carriers of all sizes can continue to negotiate an equitable solution to this matter. This oversight hearing will be very helpful in framing the issues, after which a number of us in Congress may want to sit down with industry leaders to discuss specific options.

Senator PACKWOOD. I might add that we received requests to testify on this subject from a number of groups or individuals beyond the witnesses who are scheduled to testify. I have tried to avoid overlap. In many cases, those requesting to testify would have been testifying as to exactly the same position that other witnesses have. Unless we were going to go 5, 6, or 7 days all day to accommodate everyone who wanted to testify, we simply had to make some subjective judgment as to who should come and who should not, bearing in mind we were trying to cover the major issues that were of concern.

And so, for those who did not get to testify, I apologize. I know it is a problem that Senator Long recalls when he was chairman of the Finance Committee. You can never fit everybody in who wants to testify, and you just do the best you can.

Senator LONG. Mr. Chairman, I do hope that we will be able to hear at least one or two witnesses who are not scheduled. For example, as of now, the last I heard of it, there was no arrangement made to hear a witness from the Association of State Regulatory Commissioners, those who represent the State regulatory body. I think it would be appropriate that even though the request from them was late, we should hear that witness. I believe there is one from the American Public Power Association desiring to speak. I hope that it will be arranged that we hear a witness from that group.

Senator PACKWOOD. Well, if we do, we may have to go into another day of hearings, because we have many more people that would like to testify, and we are lucky if we can do 12 to 14 witnesses a day.

Senator LONG. Yes, sir. Well, I am sure you can understand, though, the importance of having one who testifies, for example, for all those utility commissions out there that have a responsibility parallel to ours, except that theirs is at the State level. I really think it is appropriate that we should hear from them, even though they made a request late. In view of the responsibility they have, we should hear them.

Senator PACKWOOD. Well, let us go on with our first panel, Mr. Flanders, Mr. Bellum, Dr. Cooper, and Mr. Hertog. Gentlemen, following the rule in this committee, your entire statement will be placed in the record in full. We would ask that you hold your oral presentations to 5 minutes. Unless you have worked out some different arrangement, we will take you in the order that you appeared on the witness list.

Mr. Flanders.

STATEMENTS OF J.B. FLANDERS, GENERAL MANAGER, ARIZONA ELECTRIC POWER CO-OP; DONALD P. BELLUM, PRESIDENT, CYPRUS COAL CO., ACCOMPANIED BY JOSEPH LEMA, VICE PRESIDENT FOR TRANSPORTATION, NATIONAL COAL ASSOCIATION; MARK COOPER, CONSUMER FEDERATION OF AMERICA; AND JOHN HERTOG, SENIOR VICE PRESIDENT FOR LOCAL MARKETING, BURLINGTON NORTHERN RAILROAD

Mr. **FLANDERS.** Mr. Chairman and members of the subcommittee, my name is Jerry Flanders, and I am general manager of the Arizona Electric Power Cooperative in Benson, AZ.

I appear here today on behalf of AEPCO and the 1,000 other members of the National Rural Electric Cooperative Association. For most rural cooperatives and the consumers they serve, the Interstate Commerce Commission represents the only potential source of protection from the market abuse in those circumstances where competitive alternatives are not available.

The Commission, however, has totally ignored the balance of shipper and carrier interests incorporated into the Staggers Rail Act of 1980, and has permitted the establishment and maintenance of exploitive rail rates and service conditions with respect to coal and other captive shippers.

It is for this reason that the NRECA vigorously urges congressional enactment of Senate bill 477, the Consumer Rail Equity Act, to correct the Commission's misguided approach to regulation under the Interstate Commerce Act.

Inaction by Congress will continue multiplication of both the number and magnitude of captive shipper abuses. Small shippers in particular will continue to be harmed by these effects unless Congress steps in. AEPCO's own experience over the past 7 years, experience which is not unique among coal and other captive shippers, illustrates how biased Commission action and railroad revenue ambition have led to a situation wholly inconsistent with Congress' intent in 1980.

Beginning in the early 1970's, following the OPEC oil embargo, AEPCO undertook an ambitious congressional program, including the construction of 275-megawatt coal-fired units at Cochise, AZ. Coal for the Cochise units comes from the Mentmore Mine near Gallup pursuant to a supply agreement with Carbon Coal Co., which runs until 1994. AEPCO's agreement with Carbon in turn makes it captive to the only two railroads that combine to provide service to Cochise, the Santa Fe and the Southern Pacific.

There are no inland waterways or coal slurry pipelines remotely adjacent to either Gallup, NM, or Cochise, and the coal volumes and numerous logistical problems rule out motor carriage as a potential alternative. In 1973, AEPCO received a rail rate quotation of $5.80 per ton, a rate substantially higher than those in effect on other similar movements.

A year later, despite the fact that tonnage had increased dramatically, the railroads raised their quoted rate to $7.04 per ton. After 2 years of unproductive negotiation, AEPCO filed a complaint with the ICC in 1977, seeking prescription of a rate of $4.67 per ton, which was a reasonable maximum based upon prevailing rates for the comparable movements. The railroads countered with a demand for an even higher rate of $8.64, over twice the cost of service, which the Commission quickly approved.

Rates then continued to rise through ex parte general increases approved by the Commission until by April 1980 they had reached $12.30 per ton. In May 1980 AEPCO filed a second complaint challenging the $12.30 rate. The administrative law judge found the rate unlawful to the extent it exceeded $10.88 per ton, and the carriers were ordered to reduce their rates and pay reparations.

In 1982, however, the full Commission reversed this decision and vacated the administrative law judge's order. While it later confessed error and reinstated AEPCO's complaint, it never reinstated the administrative law judge's decision. Today, over 5 years after filing its complaint against the $12.30 rate, AEPCO is back before the Commission seeking a reasonable rail rate.

Meanwhile, the railroad's charges have continued to rise, and now stand at $15.83 per ton, some 273 percent higher than the 1977 rate of $5.80, a rate which we felt the evidence showed was too high even then. When placed alongside charges on other western unit train movements, the rate charged AEPCO by the railroads is over one-third most rates on similar movements and almost double others.

Moreover, when one considers the rates AEPCO likely would be paying if it had access to effective, competitive transportation alternatives, the overcharge permitted under the current ICC policies takes on a truly incredible proportion. Rates recently negotiated between coal shippers and carriers in a competitive atmosphere have come in at between 12 and 14 mils per ton mile. The current AEPCO rate is over 30 mils.

At 14 mils, the AEPCO movement would produce a rate of $7.07 per ton, less than half the current charge. This means that a full $8.76 per ton, upward of $5.8 million per year, is a monopoly premium, the price of AEPCO's captivity. We are at a complete loss as to how the Commission can justify such pricing as consistent with the balance struck by Congress in 1980, yet a full 5 years after filing our second complaint, our rate level remains unabated. Experience has convinced us that congressional action is the only answer to the grossly inequitable situation faced by captive shippers today.

On behalf of AEPCO and NRECA, I strongly urge this subcommittee to support S. 477 and restore balance to the application and administration of the Interstate Commerce Act. I thank the subcommittee for affording me the opportunity to appear today.

[The statement follows:]

STATEMENT OF J.B. FLANDERS, ON BEHALF OF THE NATIONAL RURAL ELECTRIC COOPERATIVES ASSOCIATION

Mr. Chairman and members of the Subcommittee, my name is J.B. Flanders and I am General Manager of the Arizona Electric Power Cooperative ("AEPCO") of Benson, Arizona. I appear before you today on behalf of the National Rural Electric Cooperatives Association, of which AEPCO is a member. NRECA is a national service organization whose membership consists of roughly 1,000 rural electric cooperatives, supplying electricity to over 25 million people in 46 states. This statement also represents the views of five individual NRECA systems that are also members of Consumers United for Rail Equity: Alabama Electric Cooperative, Arkansas Electric Cooperative Corporation, Dairyland Power Cooperative (Wisconsin), South Mississippi Electric Power Association, and Western Farmers Electric Cooperative (Oklahoma). These cooperatives serve more than one million rural electric consumers in their respective service areas. I appreciate the opportunity to appear before the Subcommittee today to address matters related to the Interstate Commerce Commission's implementation and administration of the Staggers Rail Act of 1980.

Electric cooperatives are non-profit entities, which exist essentially as collective extensions of their consumer-customers. The full cost of power generation—including fuel purchase and transportation—is borne directly by the ratepayer, who is entitled to a rebate when cost savings are achieved, but must pay increased rates whenever one or more components of that cost experience an increase. Among these cost components, one of the largest and most volatile is transportation.

Like other power generating systems (investor-owned utilities, municipalities, etc.), most rural cooperatives are heavily dependent upon coal to fuel their boilers. This reliance on coal, in turn, makes us dependent upon railroads, which generally represent the only economically feasible method of transporting coal in sufficiently large volumes for the production of electricity.

According to general industry statistics and a study sponsored by the ICC in 1982, well over 50% of the coal-burning utilities in this country may be considered "captive" to a given railroad. Among rural cooperatives the percentage can be even greater, since they are more often located in rather remote areas accessible only by single rail carriers. As captive shippers, cooperatives lack the kind of bargaining leverage necessary to negotiate satisfactory rate levels with the railroads. Unable to turn to competitive alternatives to counter the threat of rail market power abuse, they must look to the ICC—the agency vested by Congress with authority and responsibility over railroad rates and service practices—for protection.

The Staggers Act was enacted in 1980 to meet the twin goals of (1) improving railroad revenues and efficiency by deregulating pricing and services in markets where they face effective competition; and (2) protecting captive shippers—especially coal shippers—and the consumers they serve from market power abuse in those circumstances where competitive alternatives are not available. Unfortunately, the ICC has ignored the balance of interests incorporated into the Act, and through its decisions has permitted the establishment and maintenance of exploitive rail rates and service conditions with respect to coal and other captive shippers.

The Commission's principal failures have been in certain key rulemaking contexts, including determinations of revenue adequacy, standards for maximum reasonable rates, market dominance, rate adjustments for inflation, and problems of competitive access. In addition to allowing the railroads virtually unfettered pricing freedom on captive traffic since 1980, the ICC's actions have had the equally egregious effect of protecting and perpetuating the excessive, market abusive rates set by many coal carriers in the several years prior to enactment of the Staggers Act.

I will leave to others an explanation of the specific errors and problems in each of the individual ICC rulemakings which have given rise to the oppressive conditions under which captive shippers now find themselves. Instead, in the balance of my testimony I shall relate AEPCO's experiences with the railroads and the ICC since the mid-1970's—experiences not dissimilar from those of numerous other coal receivers—in order to illustrate how the combination of biased Commission action and railroad revenue ambition has produced a status quo which is wholly inconsistent with Congress' intent in 1980, and cries out for Congressional correction today.

THE NATURE OF AEPCO'S OPERATIONS

The power generated by AEPCO is marketed to residential and commercial consumers in Arizona and parts of Southern California by seven member systems: Anza Electric Cooperative, Inc.; Duncan Valley Electric Cooperative, Inc.; Graham County Electric Cooperative, Inc.; Mohave Electric Cooperative, Inc.; Sulphur Springs Valley Electric Cooperative, Inc.; Trico Electric Cooperative, Inc.; and the City of Mesa, Arizona.

In the twenty-three years since AEPCO was formed, the makeup of its members' service areas has changed substantially. For many years, the areas usually served by member cooperatives were predominantly agricultural. There were also some small to mid-sized industrial, mining and commercial enterprises which helped to sustain the growth of new communities growing up around highways and rail lines. In the past decade, however, farming and ranching in the members' service areas declined and, contemporaneously, the copper mining industry grew. Over the last several years, a large share of the power sold by AEPCO member systems has gone to two such customers: Phelps Dodge Corporation and the Anamax Mining Company.

Prior to the actions of OPEC and the ensuing energy crisis, AEPCO relied exclusively upon natural gas and oil as the boiler fuel used in its electric generation. In the early 1970's, however, following the oil embargo and the national call for increased utility use of coal as a substitute fuel, AEPCO undertook an ambitious conversion program. Initially, the plan was to build one 100 megawatt coal-fired unit at AEPCO's Apache Generating Station at Cochise, Arizona. When Phelps Dodge announced they would need a full 100Mw for their copper mining operation, however, our plans expanded to two 175 Mw coal units. These were constructed in 1975–78, at a cost of over $270 million.

The result of AEPCO's coal conversion effort has been the near complete displacement of oil and gas-fired power; over 90 percent of our power requirements are now satisfied through coal-fired generation.

AEPCO'S COAL SUPPLY AND RAIL CAPTIVITY

The coal units at Cochise were designed to burn up to 1.5 million tons annually. To supply them, AEPCO originally reached an understanding with the Pittsburg and Midway Company to supply coal from the McKinley Mine near Gallup, New Mexico. In 1974, this coal would have cost about $6.00 per ton. After the OPEC embargo, however, P&M withdrew their offer, believing they could now obtain $16.00 for the same coal. AEPCO was thus required to look elsewhere.

In 1976, AEPCO was finally able to find suitable alternative reserves (in terms of heat value, sulfur content, etc.), also in the Gallup area. AEPCO became a joint lessee of certain coal properties, which it then sub-leased to Carbon Coal Company for development on a "cost-plus" basis. Under the lease agreement, AEPCO advances funds to finance development of the project—known as the Mentmore Mine. The supply agreement with Carbon runs until 1994, and since its effective date AEPCO has taken between 660,000 and 1.2 million tons annually, depending upon power demand.

The terms of AEPCO's supply arrangement ties us to the Mentmore Mine until 1994. This dependence, in turns, makes AEPCO captive to the two railroads that combine to provide service between Gallup and the Apache Station at Cochise: the Atchison, Topeka & Santa Fe, and the Southern Pacific. ATSF is the only rail carrier serving the Mentmore Mine. Traffic originates there and travels south to Deming, New Mexico where it is interchanged with the SP, the only rail carrier serving Cochise. There are no inland waterways or coal slurry pipelines remotely adjacent to either Gallup or Cochise, and the coal volumes involved and numerous logistical problems (highway weight limits, distance, etc.) effectively rule out motor carriage as a potential alternative. AEPCO is—and since 1978 has been—completely captive to the joint line service provided by ATSF and SP. Since we began moving coal out of Mentmore, 100% has been transported to the Apache Generating Station via these lines. Even if we were somehow able to change the source of our coal, we would still remain dependent upon SP for delivery of all coal burned at the Apache Station.

THE AEPCO RAIL RATE DISASTER

Exposed by its absolute captivity, AEPCO's fortunes at the hands of the ATSF and SP, abetted by decisions and policies of the ICC, are an all too-real example of the damage which can be and has been done to the interests of captive shippers and the consumers they serve under the railroad welfare program which has passed for "regulation" over the past 5–7 years. AEPCO is a case history of the need for legislative action to return some semblance of balance to the application of the Interstate Commerce Act.

In August, 1973, rate "discussions" began between AEPCO and the railroads, and in November of that year we received a quotation of $5.80 per ton. We found this price unreasonable—in light of cost analyses and rates on similar movements—for the 505 mile movement from Gallup to Cochise, and resolved to continue to seek to negotiate a more equitable arrangement. In 1974, when our tonnage projections increased dramatically due to Phelps Dodge's requirements, we expected that the additional annual volume (some 600,000 tons) would entitle us to a lower rate. To the contrary, however, the carriers raised their quoted rate to $7.04 per ton. Notably, they never offered any cost-based or other justification for the price hike.

By 1977, scheduled start-up of the new Apache units was fast approaching and negotiations were going nowhere. AEPCO therefore filed a complaint with the Commission under 49 U.S.C. § 10707, seeking a prescription of $4.67 per ton—a rate which our analysis showed to be a reasonable maximum based upon prevailing rates for comparable movements. The railroads countered with a demand for an even

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higher rate of $8.64, and a notice that they would seek ICC approval of this rate as a "Capital Incentive Rate." Enacted in 1976 as 49 U.S.C. § 10729, the Capital Incentive Rate provisions of the Interstate Commerce Act prescribed certain rail rate-filing procedures which offered expedited agency consideration of qualifying rates and—if approval was won—a five-year prohibition against subsequent shipper challenges.

Congress repealed Section 10729 in 1980, largely because rail carriers were using it as a weapon rather than as a device for implementing shipper-carrier rate agreements, as Congress had intended. One of the pre-1980 victims of the abuse of Section 10729, however, was AEPCO; in 1977 the Commission approved the $8.64 demanded by ATSF/SP as a Capital Incentive Rate, and subsequently dismissed AEPCO's complaint.

Despite the fact that the $8.64 rate was enormously profitable (according to AEPCO's evidence, the carriers' cost of providing the service was close to $4.00 per ton), the carriers continued to raise the rate through so-called "ex parte" increases approved by the Commission, until it stood at $12.30 per ton by April, 1980. At this level, AEPCO was paying over $13 million per year for rail transportation alone.

In May, 1980, AEPCO tried again, and filed a complaint challenging the $12.30 rate as unlawful to the extent it exceeded the $8.64 Capital Incentive level. (Actually, AEPCO's evidence showed that a reasonable maximum would have been $7.83, but the 5-year prohibition in Section 10729 at the time prevented our going below $8.64.) After denying a railroad motion to dismiss the complaint on grounds that the entire $12.30 rate (not just $8.64) was "protected" by Section 10729, an ICC Administrative Law Judge found the rate unlawful to the extent it exceeded $10.88 per ton, and in Docket No. 37437 ordered the carriers to reduce the prevailing rate and pay reparations. Even this meagre success, however, was to be short-lived.

On March 30, 1982, in response to a railroad appeal, the full Commission decided that 49 U.S.C. § 10729 did in fact protect the entire $12.30 rate, and therefore overturned the ALJ's rate order. AEPCO immediately appealed to the U.S. Court of Appeals for the Ninth Circuit. Instead of defending the 1982 decision, however, the Commission reconsidered the matter and, in 1983, finally ruled that 49 U.S.C. § 10729 did not protect the AEPCO rate above $8.64 per ton after all. Docket No. 37437 was reopened, and AEPCO's court appeal was dismissed as moot.

Today, over five years after filing its complaint against the $12.30 rate, AEPCO is back before the Commission, once again seeking from the regulatory authority that which we have been unable to achieve through negotiation: a reasonable coal rate. During the pendency of AEPCO's case, however, the railroads' charges have continued to rise. They now stand at $15.83 per ton, some 273% higher than the 1977 rate of $5.80 which—in our view—was itself unreasonably high.

In proceeding once again before the Commission, AEPCO will be presenting its third complete set of evidence regarding the lawfulness of the Cochise rate. This time we apparently will have to use the absurd "stand-alone" method which the Commission recently hatched in Ex Parte No. 347 (Sub-No. 1). We have no choice but to play the game—the carriers who dominate our traffic refuse to negotiate meaningful rate reductions, we have no leverage to force them to, and our commitment to our member systems and the consumers they served demand that we keep trying. Seven years of banging our heads against the wall set up by the ICC to protect the exhorbitant railroad coal profits, however, has taught us to not expect much.

THE IMPACT OF THE AEPCO RATE TODAY

When placed alongside charges on other Western unit train movements not under contract, the rate charged AEPCO by ATSF/SP and blessed under the ICC's interpretation of the Interstate Commerce Act stands out as clearly excessive. Measured on a mills per ton-mile basis, a standard method of comparing rates, AEPCO's $15.83 rate weighs in at 31.3 mills. This is over 1/3 higher than most rates on similar movements, and almost double others, as the following table illustrates:

COMPARISON OF UNIT TRAIN RATES

Utility	Origin	Destination	Rate	Mills
Oklahoma Gas & Elec	Belle Ary, WY	Fort Gibson, OK	$18.10	15.5
Iowa Public Service	Caballo Jct., WY	Sergeant Bluff, IA	14.03	18.13
Western Farmers Elec. Co-op	Buckskin Jct., WY	Ft. Towson, OK	23.69	17.61
Central Power & Light	Axial, CO	Coleto Creek, TX	29.93	21.4

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COMPARISON OF UNIT TRAIN RATES—Continued

Utility	Origin	Destination	Rate	Mills
Dairyland Power Co-op	Belle Ayr, WY	Alma, WI	20.33	16.54
Iowa Southern Util.	Eagle Jct., WY	ISU Station, IA	15.39	15.9
Portland General Elec	Belle Ayr, WY	Castle, OR	21.64	20.17

Viewed next to rates on comparable coal movements, the 31.3 mill rate being paid by AEPCO is well above prevailing levels on other non-contract coal traffic. Even in a "slow" year, when AEPCO burns less than 670,000 tons at Cochise, the current rate results in a transfer of over $10.6 million from the pockets of AEPCO members' ratepayers to the coffers of ATSF and SP. The magnitude of the AEPCO overcharge graciously permitted under current ICC policies takes on near incomprehensible proportions, however, when one considers the rates AEPCO likely would be paying if it had access to effective, competitive transportation alternatives.

It is no secret that many rates recently negotiated between coal shippers and cariers in a competitive atmosphere and embodies in mid to long-term contracts have fallen in the 12-14 mill range. At 14 mills, the 505 mile AEPCO movement would produce a rate of $7.07 per ton (505 x .014 = 7.07), less than half the current charge. If this roughly approximates a competitive rate—and all indications among trade reports are that it does—it means that a full $8.76 per ton of the AEPCO rate is the product of AEPCO's captivity. Again, during a "slow" 670,000 ton year, this translates into a $5.7 million monopoly premium extracted from AEPCO's customers by the railroads.

We are at a complete loss as to how the Commission can justify such pricing as consistent with the balance between shipper and carrier interests struck by Congress in 1980. Yet, a full five years after filing our second complaint, our rate level remains unabated.

The impact of the high rail rates sanctioned by the ICC and borne by AEPCO is particularly striking when viewed in the context of AEPCO's general financial situation. Between 1979 and 1983, total delivered power dropped by 912,158,000 kilowatt hours (over 33 percent). During the same period, however, the cost of generating power (in mills per kwh) shot up by over 108 percent (from 31.6 to 65.9 mills). Rail rates were a strong contributor to this increase, rising by over 45 percent between December 1, 1979 and January 1, 1984.

The drop in power demand was caused in large part by a general decline in the copper industry and, more recently, the federal Payment-In-Kind program (which drastically reduced demand for electricity for irrigation). AEPCO responded to the severe revenue loss in the face of rising power production costs by laying off employees (12% of the workforce in 1983), freezing wages, deferring maintenance, curtailing production and reducing inventories, among other efforts. The railroad rates, however, have remained at high levels, and continue to be raised every time the Commission's Cost Recovery Index shows an increase. Thus, despite the rather draconian measures adopted by AEPCO management, AEPCO still suffered a net operating loss of over $11 million in 1983, and was forced to seek a service rate increase from the Arizona Corporation Commission for 1984. ATSF, by contrast, posted record earnings.

AEPCO cannot immediately pass on increased rail rates to its customers; automatic fuel adjustment pass-throughs were eliminated some time ago in Arizona. Today, every effort to adjust customer rates to cover fuel cost increases must be approved by the ACC. The rail rates must be recovered eventually from someone, however, if AEPCO is to continue operating—we cannot run net revenue losses every year and survive. It seems inevitable, then, that unless some force intervenes to produce a meaningful reduction in AEPCO's rail rate and reparations for past charges, AEPCO's customers will be required to foot the multimillion dollar rail rates excesses in their monthly electric bills.

CONGRESS MUST ACT

Our experience since 1978 makes clear that the intervening "force" must be the U.S. Congress. For as long as we can recall, the ICC has been telling AEPCO and other captive coal receivers to "trust us—relief is coming." We have waited, paid rates twice as high as competitive levels, prepared our case, argued our case (twice), and came away (twice) emptyhanded. From this frustration we have learned a simple, painful lesson: a captive coal shipper has no serious chance for rate relief under current ICC policy and statutory administration. The balanced approach to railroad-shipper relations, particularly in the rate area, which Congress built into the law in 1980 has been abrogated by the ICC to the serious detriment of captive shippers and their customers. Congress must now step in and restore the equilibrium—there is no alternative.

On behalf of AEPCO, NRECA and the five additional rural cooperatives who are members of Consumers United for Rail Equity, I strongly urge Congressional consideration and enactment of S. 477, the Consumer Rail Equity Act, to correct the Commission's misguided approach to regulation under the Interstate Commerce Act. AEPCO's case is not unique, and the price of Congressional inaction will be continued multiplication of both the number and magnitude of captive shipper abuses.

Again, I appreciate the opportunity to appear before the Subcommittee today, and I would be happy to answer any questions.

Senator **Packwood**. Thank you, sir.

Mr. Bellum.

Mr. **Bellum**. Mr. Chairman, my name is Donald P. Bellum. I am president of Cyprus Coal Co. We have about 15 million tons per year of production, all of which we ship by rail to our customers. I am also a member of the National Coal Association's board of directors, and I serve as chairman of the NCA's transportation committee, and I am appearing on behalf of the National Coal Association.

I am also accompanied today by Joe Lema, vice president of transportation for NCA.

I am here to report to you today that we, the coal industry, were and still are a strong supporter of the Staggers Act. However, some modifications are needed in the Interstate Commerce Act in order to achieve the Staggers Act objectives, and to protect the captive shipper. Most mines that produce the coal and the utilities and the industrial plants and the ports that receive the coal are served by single railroads. It is a rare luxury when we have railroads competing to transport our product. When a commodity like coal has no competitive alternative to single railroad carriers to transport its product to its customers, there must be some rational level of regulation and regulatory protection. The protection is possible under the Staggers Act, but unfortunately, the Interstate Commerce Commission has neglected the captive shippers, especially the coal shippers, in its administration of the Staggers Act.

The Commission in its decisions and policymaking process has failed to balance the needs of the rail carriers, the shippers, and the public as required under the Staggers Act. Its decisions have favored the rail carriers at the detriment of the coal industry, its customers, and the public. The Consumer Rail Equity Act will ensure that the goals intended by Congress for the Staggers Act are realized.

Mr. Chairman, we have several major areas of concern for the ICC's implementation of the Staggers Act, particularly in the areas of market dominance, revenue adequacy, and maximum rail rates. Our concern with the market dominance issue is that recent ICC decisions still leave the coal producers subject to product and geographic competition.

The availability of coal from other places and the possibility that different fuels might be used by a customer should have no bearing on determining whether a coal producer is captive to a certain railroad. With the CURE legislation, market dominance criteria for

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rail movements will only be based on whether there is competitive transportation available to the originator.

Also, the Commission contends that not a single railroad in the United States is revenue adequate, yet it is impossible for me to believe, when I look at their annual reports that Class 1 railroads in this Nation do not have adequate revenue, when we see their high rates of return on equity, their strong bond ratings, the capability of buying new businesses and new equipment and facilities.

Believe me, if the coal industry had the same level of earnings as the rail industry, we would be a much more healthy industry than we are today. The CURE legislation will ensure that the Commission changes its way of measuring revenue adequacy to conform with reality.

In regard to maximum reasonableness of coal rates, the Commission has developed coal rate guidelines which are overly empirical and require assumptions that are highly theoretical. There are no rational relationships between the rail rates determined by the guidelines and the cost that is incurred by the rail carrier in providing the transportation service.

The CURE legislation will alleviate these problems. I am sure you know that the Staggers Act called for a policy of maintaining reasonable rates where there is an absence of effective competition. The Senate and the House conferees on the Staggers Act confirmed that this policy would include encouragement and promotion and protection of the transportation of coal by rail, and if I might quote, "at rates which do not exceed a reasonable maximum where there is an absence of effective competition."

The ICC's implementation of the act has not been consistent with this concept. For these reasons, the NCA strongly urges that members of this committee support the passage of the Consumer Rail Equity Act. This will enable the Staggers Act to maintain the balanced goals that were intended at its enactment.

Mr. Chairman, this concludes my testimony. I will be glad to answer any questions that you have either in writing or in person.

[The statement follows:]

STATEMENT OF DONALD P. BELLUM, ON BEHALF OF THE NATIONAL COAL ASSOCIATION

Mr. Chairman, my name is Donald P. Bellum. I am president of Cyprus Coal Company headquartered in Englewood, Colorado. My company produces coal in Kentucky, Pennsylvania, Virginia, Colorado, and Utah. I am appearing before you on behalf of the National Coal Association. Presently I am a member of NCA's Board of Directors and the chairman of NCA's Transportation Committee. NCA represents producers, sellers, and consumers of coal and other organizations associated with America's coal industry.

SUMMARY OF TESTIMONY

Yearly about 64 percent of America's total cost production is transported by railroad. Often a single rail carrier represents the only effective transportation for all or part of coal's journey from mines to consumers or to ports engaged in coal transshipment. Therefore, the coal industry has a strong interest in maintaining a healthy railroad industry capable of providing competitive, efficient, and reasonably priced coal transportation services.

NCA took a lead role in voicing the needs of shippers during the legislative process leading to enactment of the Staggers Rail Act in October 1980. We supported the Staggers Act in the form in which it was enacted. Now because of numerous inappropriate decisions by the Interstate Commerce Commission since the enactment of the 1980 Staggers Act, we have serious concerns about the treatment of coal producers, sellers, consumers, and shippers under present law. Thus we warmly appreciate your leadership, Mr. Chairman, and the interest of this Subcommittee in holding this hearing on the Staggers Act and in allowing NCA to present views of the coal industry on where we stand five years after the Staggers Act was enacted. Because of the Commission's actions with regard to regulatory standards during the past five years, we believe the time is ripe for legislation to preserve the goals of the Staggers Act. Accordingly, NCA supports passage of the Consumer Rail Equity Act now before the Congress. NCA is a member of a coalition formed by Consumers United for Rail Equity, CURE, to seek passage of the legislation.

The legislation would correct problems created by Interstate Commerce Commission decisions and interpretation of the Staggers Rail Act since its enactment. The Commission has ignored the intended linkage in goals of the Staggers Act aimed at assisting railroads to remain viable while, at the same time, providing a regulatory process that balances the needs of rail carriers, shippers, and the public. Since 1980, the Commission, by its decisions on regulatory standards, has abandoned captive shippers that require effective regulatory protection.

The coal industry is dismayed at the Commission's lack of sensitivity to captive shippers. Given a free market choice, we would opt for increased transportation competition. This nation needs intramodal and intermodal competition, among railroads, coal pipelines, and water carriers, rather than reliance on the Commission to avert abuses in rail rates and services. However, it is obvious that a critical need for adequate regulatory protection still exists because of railroad market dominance over coal shipments. That leads us to urge the Congress to arrest the Commission's abuse of regulatory discretion which if unchecked, surely will signal failure of the Staggers Act.

The key elements of the Consumer Rail Equity Act which the coal industry believes are critical deal with market dominance, exemptions, revenue adequacy, and coal rate guidelines. The bill would eliminate consideration of product and geographic competition from the determination of market dominance with respect to the origin of a movement. After all, a coal mine is not a movable operation; the decision of market dominance should rest solely on whether effective intramodal or intermodal transportation competition exists when looking at the question from the position of the traffic origin. Further, the legislation would prohibit the Commission from exempting captive traffic from regulation, as the Commission has previously attempted until reversed by the court in the export coal case.

Two other colsely interacting decisions of the Commission must be corrected, and the bill supported by NCA and CURE would do so. These deal with determinations on revenue adequacy and maximum reasonableness of railroad coal rates. First the Commission's fixation on unique, mistaken criteria for measuring revenue adequacy, leading to the unbelievable finding of the Commission that no Class I rail carrier has achieved revenue adequacy, must be undone. The problem is compounded by the Commission's September 3rd notice in which it adopted its so-called constrained market pricing in regard to coal rates. That approach gives imprecise, yet obviously generous, leeway to rail carriers which have not achieved revenue adequacy, in their rates charged coal movements.

The Commission's approach is to look at maximum reasonableness of a certain rate in comparison with what shippers would pay if a simulated, transportation alternative were to be built, with no definitive guidance as to revenues to be contributed by the competitive traffic assigned to the empirical system in addition to revenues to be generated by captive traffic on the theoretical alternative. this stand alone costing methodology is unrealistic and argumentative, and fails to definitively reflect rail productivity.

The Staggers Act established a policy to maintain reasonable rates in regard to rail transportation: but decisions of the Interstate Commerce Commission have disregarded that policy.

The Staggers Act, in Section 3 which establishes specific goals, clearly sets a goal of providing a regulatory process that balances the needs of carriers, shippers, and the public. This goal connects directly with the rail transportation policy that the Act placed into law, particularly in title 49, United States Code, subsection 1010a(6) which provides that in regulating the railroad industry, it is the policy of the United States Government—to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital.

The mandate for reasonable rates is notably reinforced by a statement in the report of the Senate and House conferees at page 80 of House of Representatives Report NO. 96-1430 which reads—"The Conferees intend that this (rail transportation) policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition."

Mr. Chairman, recently we have heard comments to the effect that reasonable railroad coal rates constitutes an issue which can be dealt with merely by examining what has happened to such rates since the October 1, 1980 effective date of the Staggers Act. This apparently is the perspective taken in the draft report on the first phase of a study of railroad coal transportation performed by the U.S. Department of Energy. Railroad industry representatives also are inclined to look at the question in the same limited fashion. On the other hand, we do not read the Staggers Act to say that rail rates reasonableness is a matter that rests merely with how rates have changed since the enactment of the legislation in October 1980

What really counts is the relationship year-to-year between railroad coal rates and costs of providing railroad coal transportation services and productivity factors influencing output with regard to goal movement. This relationship should not be analyzed simply during post-Staggers Act years. Using data from the U.S. Bureau of Labor Statistics and the Association of American Railroads, for instance, we find that on the average railroad coal rates increased 113 percent from 1975 to 1983 while the Producer Price Index increased only 73 percent and railroad inflation increased 111 percent. With additional data from the Interstate Commerce Commission and the U.S. Energy Information Administration we find in the same period that the average rail rates per ton-mile for movement of coal increased by 53 percent whereas the average price of coal at the mine increased only 35 percent. These figures certainly reveal that there is a need for new efforts to hold down rail costs, although as yet there is a lack of sufficient information available on accurate and verifiable rail costs for particular movements. Hopefully, such information will be available to carriers, shippers, and the public when the Railroad Accounting Principles Board has completed its work by early 1987 and a new body of sound railroad accounting principles is utilized to govern rail costing systems.

In the period, 1975 to 1983 coal mine productivity measured in average tons of coal produced per coal miner per day increased 44 percent. The benefits of increased coal mine productivity flow substantially to coal consumers and the public because of intense coal supply competition among numerous coal producers operating about five thousand mines in the East, and Midwest, and the West. Rail carriers also have shown improved productivity during the same years as measured in ton-miles of revenue service, however due to a widespread lack of effective transportation competition there is little incentive that the benefits of greater productivity are shared with coal shippers, especially with the Commission largely focused on ways to enhance railroad revenues and profits to the expense of captive shippers and the public.

There is considerable room for a significant lowering of railroad coal rates commensurate with accelerated increases in railroad productivity from 1975 to 1983. During this period, for instance, revenue ton-miles per employee-hour paid increased 59 percent, revenue ton-miles per gallon of fuel consumed increased 29 percent, and revenue ton-miles per rail car loaded increased 36 percent. The experience of Class I railroads which account for 95 percent of the Nation's freight, comparing 1984 with 1983 further reveals a strong showing with regard to their income and performance. In 1984 their operating revenues increased 10.2 percent while their operating expenses increased only 7.0 percent and their net operating income grew 38 percent while ton-miles per train-hour of revenue service increased 13.0 percent. Surely such trends are evidence that rate increases on coal traffic are unnecessary, and in lieu thereof, there probably is significant room for lowering the rates. Consider, for example, what happened when the Public Service Board of San Antonio, Texas secured new intramodal railroad competition for the movement of coal from the Powder River Basin in Wyoming to the electric utility's Texas location. Earlier this year the rail rate was $27.66 per ton for transportation then available from a single rail carrier holding market dominance over the coal movement. When a second rail carrier became available for the transportation service the first carrier which formerly held market dominance over the traffic proposed to furnish multi-year contract service for $23.00 per ton, a reduction of 17 percent. What's more, the new competing carrier proposed to provide the service for $19.60 per ton, 29 percent less than what the utility had been paying. This experience not only demonstrates the value of transportation competition, but also shows that the first carrier was in a position to lower its rate significantly for the same service while still apparently realizing sufficient revenues from the traffic. From this circumstance it is obvious that the carrier's revenue had been much higher than necessary to provide it a reasonable rate of return and the coal shipper and the public were paying a penalty for an earlier lack of effective transportation competition.

Mr. Chairman, in Appendix A of my testimony I have included eight exhibits which consist of tables and charts that show trends in railroad coal transportation, rates, costs, and productivity to which I have made reference. They indicate that in the years that follow reduced railroad regulation under provisions of the Railroad Revitalization and Regulatory Reform Act of 1976, the 4R Act, and the 1980 Staggers Rail Act, rising rail rates charged coal shippers at the same time that railroad productivity has improved markedly illustrate the fate of captive shippers when the Commission disregards its responsibility under the law. This circumstance is underscored by current experience of the electric utility in San Antonio to which I made reference earlier. Similar documentation of cases in which new transportation competition has caused pronounced reductions in coal rates charged utility shipments has been developed this year by the Edison Electric Institute. EEI found that competition lowered rates for coal movements to the Lower Colorado River Authority by 18 percent, to Arkansas Power & Light by 20 percent, to Houston Lighting & Power by 26 percent, and to Southwestern Public Service by 29 percent, graphic examples of the substantial margins above revenue requirements due to captivity.

The Consumer Rail Equity Act should be enacted in order to arrest the Commission's abuse of discretion in the regulatory process and enable full attainment of the goals set forth in the Staggers Rail Act of 1980.

The Staggers Act, in fact, amounted to an initiative that reduced rail regulation and increased rail pricing flexibility, but preserved regulatory protection of captive shippers when subject to market dominance of the railroads and the rate for a particular movement is higher than a revenue-to-variable cost threshold expressed as a percentage, which is now 180 percent. The Act did not provide total deregulation of all rail traffic. Yet, since 1980 the Commission has been performing deregulation of railroad movements in a de facto manner through its administration of the Staggers Act and its adoption of new regulatory standards and criteria, circumventing the captive shipper protection contemplated under provisions of the Act.

Classic examples are the Commission's redefinition of railroad market dominance, the attempt to exempt export coal movements from regulation, and the adoption of criteria for determining railroad revenue adequacy and maximum rate reasonableness in regard to coal traffic which allow rates to be excessive, bearing no rational relationship to the costs incurred by the railroads in providing the service, even though no effective transportation alternatives exist. NCA believes that with little adjustment, the presumptions of railroad market dominance which were in effect when the Staggers Act was enacted were appropriate and there was no need for the Commission to replace them in 1980 with standards that inject product and geographic competition into the question, in addition to consideration as to whether intramodal or intermodal transportation competition is present for a particular movement. Certainly it is inappropriate to eliminate recourse to regulatory relief on the part of originators of traffic from locations such as mines, which not movable and frequently must rely on a single rail carrier as the only effective way to haul large quantities of bulk commodities like coal for long distances just because the receiver of the commodities may have access to the same commodities or to substitutes obtained from other places. We believe, therefore, that product and geographic competition are not germane to the question of whether market dominance exists with respect to the origin of a movement, and the only relevant factors to consider in determining whether market dominance is present with respect to the origin are intramodel and intermodal transportation competition. The Consumer Rail Equity Act would help to correct this problem.

An extension of the market dominance problem created by the Commission is its attempt to exempt railroad movements of export coal from regulation. Export coal movements often originate at mines which are served by a single rail carrier and the same carrier usually is the only source of transportation to the port utilized in rail-to-water transshipment operations. Yet the Commission thought that it would be proper to exempt such traffic from regulation and access to captive shipper protection available under the Staggers Act. Surely this represents a premier example of the Commission's insensitivity to the problems faced by captive shippers, especially coal shippers. The coal industry succeeded in overturning the Commission's decision to exempt export coal traffic from regulation in the United States Court of Appeals for the District of Columbia Circuit. Yet the Commission brought the Appeals Court's decision to the United States Supreme Court in a petition for review which was denied by the Court. The Appeals Court was unambiguous in its finding that the Commission was wrong in exempting the coal traffic.

Mr. Chairman, we believe that legislation is necessary to prohibit the Commission from exempting movement's subject to railroad market dominance from regulation. In the export coal case the Commission quickly dismissed arguments of coal shippers during the regulatory proceeding on the matter, and even carried the case to the Supreme Court when it lost its arguments convincingly before the Appeals Court. This gives us little hope that similar exemption proceedings would not be undertaken by the Commission in its zeal to perform total deregulation of captive traffic in a de facto manner. The law should be amended to avert such attempts in the future.

Turning now to the issue of criteria on which the Commission bases decisions on railroad revenue adequacy and maximum reasonableness of coal rates, we believe that serious erosion of captive shipper protection which threatens the realization of the goals of the Staggers Act is occurring due to Commission decisions in these areas. The Commission's insistence on use of unique and unwarranted standards for determining return-on-investment results in a finding by the Commission that no Class I rail carrier has adequate revenues. At the heart of the problem is the Commission's failure to exclude from the investment base assets not reasonably related to providing railroad services, to exclude deferred tax reserves from the railroad rate base, to calculate the cost of existing debt based on embedded debt rates, and to use a variety of commonly accepted financial indicators to determine revenue adequacy, not just return-on-investment.

Then we find that the Commission, in its coal rate guidelines issued in final form on September 3, 1985 has adopted a "constrained market pricing" approach in which captive shippers may be required to pay differentially higher rates than other shippers until a rail carrier reaches revenue adequacy, an unlikely event under Commission standards for determining revenue adequacy. In addition, while the new guidelines indicate that a shipper should not pay for carrier inefficiency, there is no methodology presented for taking into account increases in carrier productivity in the examination of carrier efficiency and for reflecting such improvement in the rates charged captive shippers. There have been significant increases in productivity with regard to manpower utilization, fuel consumption, and equipment usage by rail carriers in the past ten years, and there remains considerable opportunity for most cost containment by the railroad industry. There is an important need to assure that productivity and efficiency benefits are passed on to captive shippers notwithstanding their lack of bargaining power with market dominant rail carriers.

The new coal rate guidelines also incorporate a constraint characterized as stand alone costing. This pricing constraint centers on simulating a least cost alternative transportation system theoretically by creating a model which constitutes what might be done empirically to establish what the shippers would pay to move their freight as if the model represented effective competition. This approach is very imprecise and uncertain, giving rise to serious questions as to whether the guidelines represent an avenue to follow in securing timely relief from abusive rail rates. In any event, the approach still calls for resolving how to assign revenue contributions to both competitive and captive movements in a way that seems to require an exhaustive, lengthy, and costly analysis with many difficult assumptions in every rate case. With that in mind, we are not convinced the guidelines are practical.

Mr. Chairman, this completes my testimony. I will be glad to respond to questions now, or in writing after this hearing.

EXHIBIT 1 **NCA/TRANS**

COAL PRODUCTION AND COAL TRAFFIC TRANSPORTED BY ALL CLASS I RAILROADS

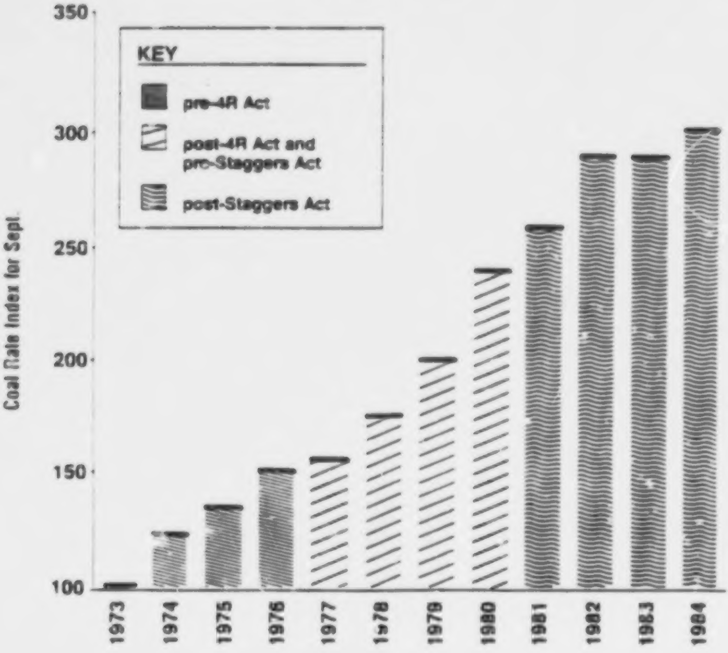
	Total Production Of Bituminous Coal, Anthracite Coal And Lignite (million tons)	Coal Transported By Rail	
		Million Tons Of Coal	Percent Of Total Coal Production
1975	655	408	62.3%
1976	685	407	59.4
1977	697	415	59.5
1978	670	383	57.2
1979	781	474	60.7
1980	830	522	62.9
1981	824	528	64.1
1982	838	524	62.5
1983	782	494	63.2
1984	890	567	63.7

Source: Department of Energy—Energy Information Administration, and Interstate Commerce Commission.

EXHIBIT 2 NCA/TRANS

CHANGES IN RAILROAD COAL FREIGHT RATE INDEX

(SEPT. 1973=100)

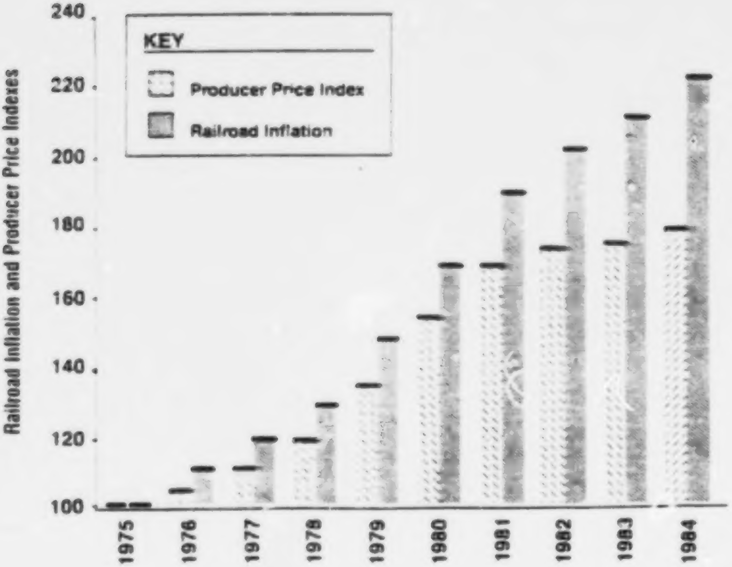


Source: Department of Labor—Bureau of Labor Statistics

EXHIBIT 3 NCA/TRANS

CHANGES IN THE PRODUCER PRICE INDEX COMPARED WITH CHANGES IN RAILROAD INFLATION YEARLY FROM 1976 TO 1984

USING BASE YEAR 1975=100



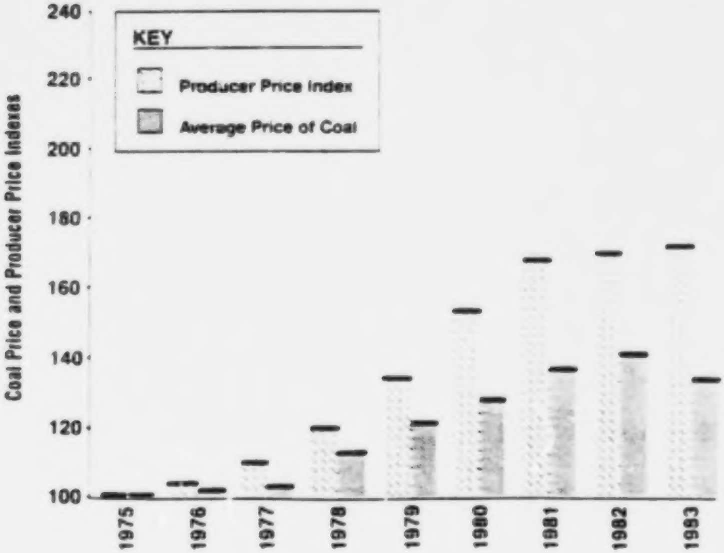
Source: Department of Labor—Bureau of Labor Statistics, and Association of American Railroads.

EXHIBIT 4

NCA/TRANS

CHANGES IN AVERAGE PRICE OF COAL PER TON AT THE MINE COMPARED WITH CHANGES IN THE PRODUCER PRICE INDEX YEARLY FROM 1976 TO 1983

USING BASE YEAR 1975=100

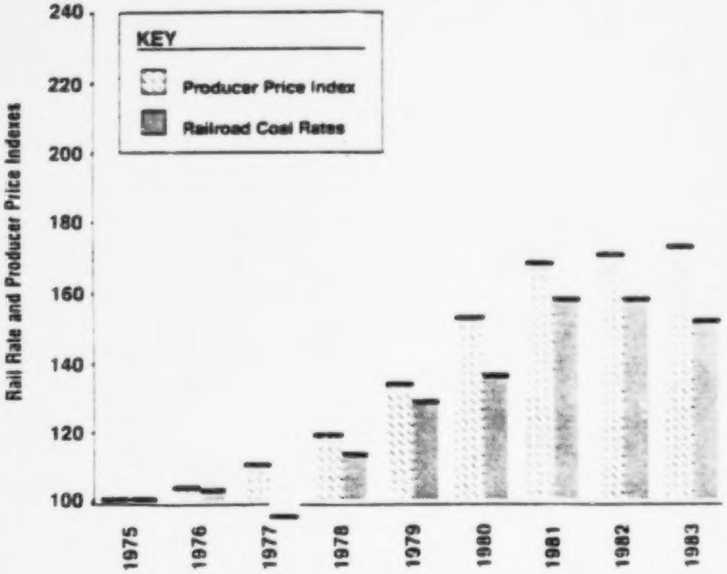


Source: Department of Labor—Bureau of Labor Statistics, and Department of Energy—Energy Information Administration.

EXHIBIT 5 **NCA/TRANS**

CHANGES IN AVERAGE RAIL RATES PER TON-MILE FOR COAL TRAFFIC COMPARED WITH CHANGES IN THE PRODUCER PRICE INDEX YEARLY FROM 1976 TO 1983

USING BASE YEAR 1975=100

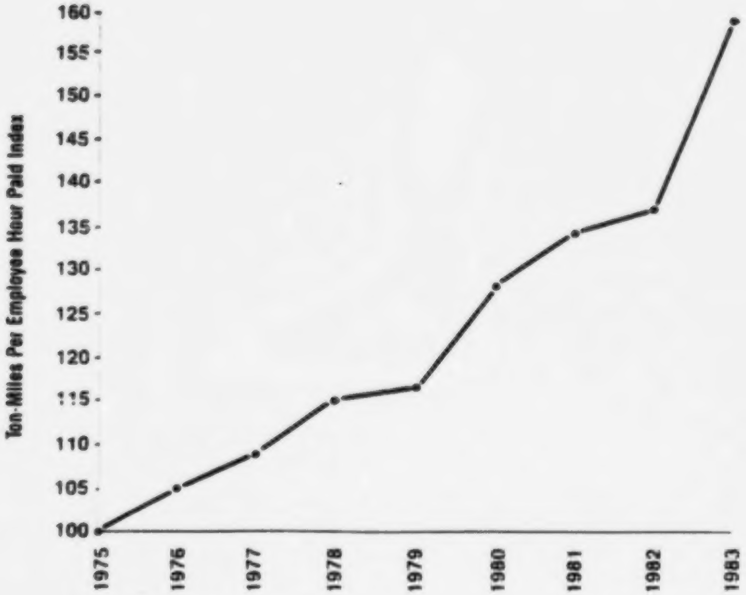


Source: Department of Labor—Bureau of Labor Statistics, and Interstate Commerce Commission.

EXHIBIT 6 **NCA/TRANS**

CHANGES IN TON-MILES PER EMPLOYEE HOUR PAID YEARLY FROM 1976 TO 1983

USING BASE YEAR 1975=100



Source: Association of American Railroads.

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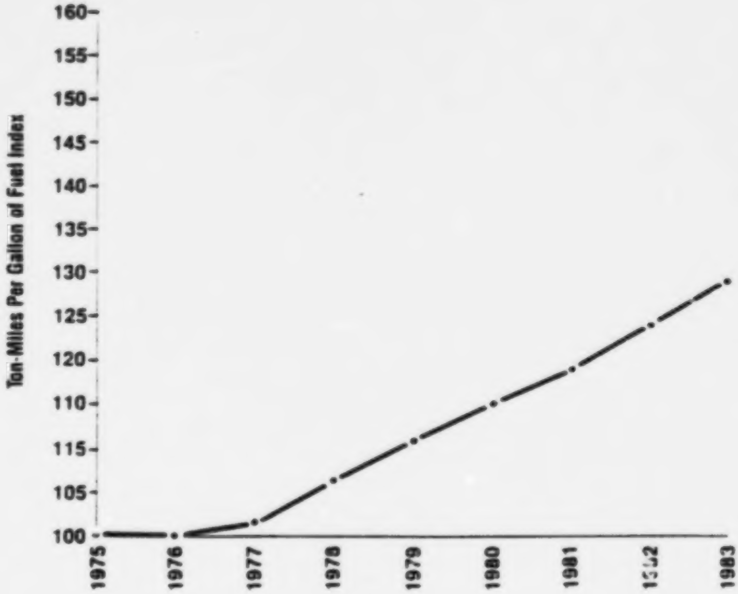
EXHIBIT 7 **NCA/TRANS**

CHANGES IN TON-MILES PER GALLON OF FUEL CONSUMED YEARLY FROM 1976 TO 1983

USING BASE YEAR 1975=100



Source: Association of American Railroads.

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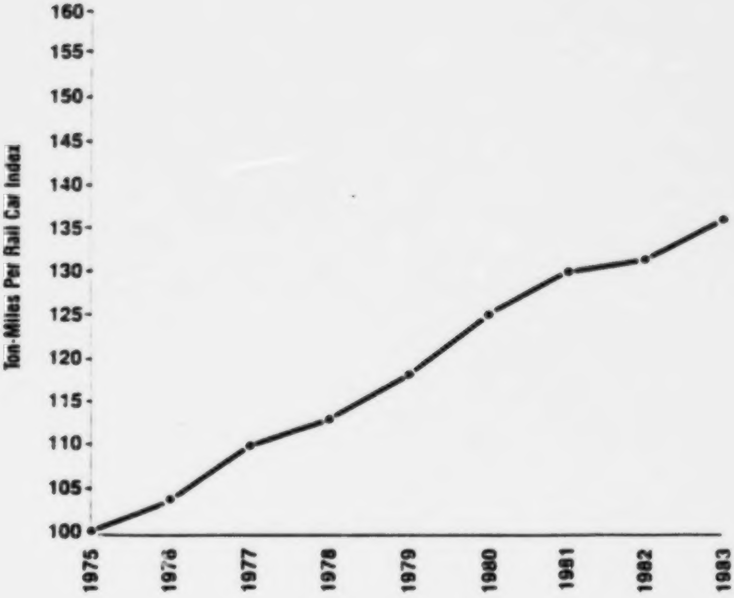
EXHIBIT 8

NCA/TRANS

CHANGES IN TON-MILES PER RAIL CAR LOADED YEARLY FROM 1976 TO 1983

USING BASE YEAR 1975=100



Source: Association of American Railroads.

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Senator **Packwood**. Thank you.

Mr. Cooper.

Mr. **Cooper**. Thank you, Mr. Chairman. The Consumer Federation of America, with 200 State and local member organizations, appreciates the opportunity to express its concerns over the implementation of the Staggers Act. Our member groups regularly participate in proceedings at the Federal and State levels, as I have on numerous occasions. We win some of those rate cases and we lose some.

But above all, we have a sense that the process is reasonable, that the rules are impartial, and the deliberative bodies are engaged in a good faith effort to balance the needs of consumers with those of the providers of monopoly services. That simply is not the case at the ICC. The scales have been so tilted in favor of the railroads and the burden placed on the complainant so onerous that we despair of getting a fair hearing or achieving a sensible result.

All we are asking Congress to do is to ensure an equitable set of rules applied by a reasonably impartial body, and we will take our chances on the process. Consumers are deeply affected by the captive shipper provisions of the law. Coal is the dominant source of energy for generating electricity in this country, and electricity is delivered to consumers under conditions of franchise monopoly. The costs of acquiring coal, including transportation, are expenses, not profit items for utilities. They are passed directly through to consumers in their bills either as fuel adjustment clauses or as expenses, which are virtually unchallengeable.

Second, coal is the commodity over which the railroads possess the greatest market power. With the major coal hauling railroads, coal accounts for over 30 percent of freight revenues, and close to 50 percent of operating profits. Electric utility consumers pay perhaps two-thirds of the coal rail freight bill. Thus we are the captives of captives, and we are also the primary source of railroad profitability.

The fact that a representative of the Burlington Northern sits on my left—geographically, not politically—provides an opportunity to make our case in most pointed fashion. Since the passage of the Staggers Act, the BN has earned almost $3 billion in profits, and paid no taxes. Its bond ratings are double A, and have been A or better since the passage of the 4R Act.

According to Forbes magazine, in the years since the Staggers Act, the BN outperformed 900 of the largest 1,000 corporations in the Nation in the stock market. It outperformed 850 on net profit margin, 575 on earnings per share growth, 550 on sales growth, and 450 on return equity. According to Business Week, its debt equity, fixed charge, and current ratios were equal to the average of the largest 500 corporations in the Nation, while its cash flow as a percent of growth needs was well above the national average.

Since the passage of the Staggers Act, the BN has acquired almost $1.5 billion in nonrail assets, and it is in the process of pushing that total to above $2 billion. During that period, roughly 80 percent of its profits were from rail operation. That looks like a pretty sound corporation, and one whose rail operations are extremely healthy, not, unfortunately, in the eyes of the ICC.

Starting from a set of accounting fictions and ending in an accounting fantasyland inhabited by it alone, the ICC believes that this poor man's corporation would have needed to double its profits in order to be revenue adequate. What would it have done with $2 to $3 billion more in net profits in that period? We do not think that the exercise of monopoly power by the railroads allowed by Congress in pursuit of a sound rail network was supposed to end up with the major coal-hauling railroads paying billions of dollars for nonrail assets. The revenue adequacy test is broken, and only Congress can fix it.

The BN also presents the most striking example of the failure of the ICC's ratemaking approach. Until very recently, the BN had a stranglehold on the Powder River Basin. Rates on coal traffic were high, very high, and everyone knew it except the ICC. When competition came to the Powder River Basin, rates fell by 30 to 40 percent. Competition was able to bring monopoly profits of 30 to 40 percent out of rates in which the ICC could not find one penny of excess.

We rejoice in the good fortune of those consumers who have recently benefitted from a rare increase in competition. But for the rest of us, competition in coal transportation is on the decline, not on the rise, thanks in significant part to the efforts of the railroads. The industry has worked vigorously against new modes of transportation. It is on a merger spree which will certainly reduce competition.

For its part, the BN fights tooth and nail against every inch of extension of track up the Powder River Basin. For those consumers who do not have competition to discipline rates, Congress legislated protection, but rate regulation at the ICC is completely ineffective, and only Congress can point the ICC in the right direction.

We believe that the changes embodied in the Consumer Rail Equity Act would set ICC rate regulation on a footing that is in touch with reality and consistent with the provisions applied by other regulatory bodies. Of course, the Association of American Railroads has been saying that we present a double standard. We want to treat railroads unfairly. That just is not the case.

Consider the following examples. Railroad representatives complain that electric utilities bill their customers for phantom taxes. We work against phantom taxes. We write Congress regularly to eliminate them. What the railroad representatives fail to say is that they pay almost no taxes, and that the ICC's treatment of these taxes is even worse, because it allows the utilities a rate of return on unpaid taxes.

Railroad representatives complain that customers of utilities are paying for unused investment. We support for electric utilities and other utilities a strict used and useful standard. What the railroad representatives fail to point out is that the ICC will not even examine its rate base, and that there has been a recent large, unjustified writeup of assets in recent years.

We believe that if there is any double standard here, it is that the ICC has been ridiculously generous and lenient in its regulation of the railroads, and we believe that Congress and only Congress can restore the balance between captive shippers and railroads by shifting the burden of proof in regulatory proceedings and stipulating a few fundamentals for establishing a sensible revenue adequacy test and maximum rates that are reasonable.

Thank you.

[The statement follows:]

STATEMENT OF MARK N. COOPER, DIRECTOR OF ENERGY, CONSUMER FEDERATION OF AMERICA

Mr. Chairman and Members of the Committee, my name is Dr. Mark N. Cooper. I am Energy Director of the Consumer Federation of America with offices at 1424 16th Street, N.W., Washington, D.C. 20036.

The Consumer Federation of America (CFA), founded in 1968, is the nation's largest consumer advocacy organization with membership encompassing more than 200 national, state and local groups. CFA's purpose is to represent consumer interests before Congress and the federal agencies.

We greatly appreciate the opportunity to appear before the Committee to share our concerns over the implementation of the Staggers Act. The Staggers Act is an excellent piece of legislation, but there are several major problems with the manner in which the Interstate Commerce Commission (ICC) has carried out the intentions of Congress, problems which we believe require carefully crafted refinements to the basic law.

What is the goal of the Consumer Rail Equity Act (S. 477)?

The solution we are proposing to the Committee (the Consumer Rail Equity Act, S. 477), is essentially a matter of procedural fairness.

In the past three years, I have appeared on behalf of consumer and low income organizations in about two dozen proceedings at the federal and state levels dealing with telephone, electricity, natural gas, and railroad ratemaking. We win some cases and we lose some. We win parts of some cases and lose other parts. But above all, we have a sense that the process is reasonable—that the rules are reasonably impartial and the deliberative bodies are reasonably objective and unbiased. There are things we would like to change and improve, but the process is fair enough that we can live with it.

That simply is not the case with the ICC's revenue adequacy and maximum rate proceedings. The scales have been so tilted in favor of the railroads and the burden placed on complainants so onerous, that we despair of getting a fair hearing or achieving a sensible result. Our feeling of despair is echoed in the sentiments of a series of judicial decisions which who have said that we have little hope of prevailing under the current rules, procedures and attitudes at the ICC (See Appendix A). All we are asking the Committee to do is to ensure an equitable set of rules applied by a reasonably impartial body and we will take our chances on the process.

Because I have spent so much time testifying in rate cases, I have prepared my testimony in the question and answer format used in those proceedings. I will begin by explaining why consumers care about these issues and what they have done in the past to try to gain relief. I will then offer an overview of the general issue as I understand it, before moving on to the specific elements of failure at the ICC and recommendations for Congressional action to rectify these problems. Finally, I will examine one of the primary sources of confusion and differences of opinion between the railroads and consumer groups that have been aired in the press and before several Congressional Committees in the past few years—the completely unfounded claims by the railroads that we are proposing a double standard.

Why are consumers concerned about the captive shipper provisions of the Staggers Rail Act of 1980?

Consumers are deeply affected by those provisions of the law because of a unique juxtaposition of economic and institutional factors.

First, as part of this nation's efforts to increase its energy security, a conscious program has been pursued to expand the use of coal, which is a domestic energy source available in virtually inexhaustive supply. Coal is now the dominant source of power for generating electricity in this country, accounting for 54 percent of the total. Hydroelectric power is a distant second with only 14 percent of the total.

Second, electricity is delivered to consumers under conditions of franchise monopoly. The cost of acquiring coal, including transportation costs, are passed directly through to consumers' electricity bills in regulatory proceedings either as fuel adjustment clauses or as expenses which are virtually unchallengeable.

Third, coal is also the commodity over which railroads possess the greatest market power. In many cases utilities are served by only one railroad, or at most a very small number of railroads, and there are no alternative means of transportation that are cost competitive.

This combination of economic factors and institutional arrangements makes electric utility ratepayers the captives of captive shippers and the largest consumers of railroad transportation services.

Coal accounts for about 40 percent of the total volume of freight transported by rail. For the major coal hauling railroads coal accounts for over thirty percent of freight revenues and close to fifty percent of operating profits.

Electric utility consumers pay about two thirds of the coal rail freight bill. Thus, we are not only the captives who need protection, we are also the primary source of railroad profitability.

Have consumer groups been active on this issue in the past?

The Consumer Federation of America has been active on this issue since before the Staggers Act became law. We lobbied Congress in 1979 and 1980 about provisions to protect captive shippers (see Appendix B). In 1983, we testified before this Committee (see Appendix C) and I filed comments in the Coal Rate Guidelines Proceeding (see Appendix D) in addition to appearing in one of the first rate cases under that proceeding (see Appendix E). In 1984 we participated in the Ex parte 456 proceeding (see Appendix F). In 1984 and 1985 we worked with other consumer and public interest groups in calling for legislation (see Appendices C and H). During 1985 we conducted extensive research into the captive shipper problem (see Appendices I—M) and testified about this problem before two committees of the House of Representatives (see Appendices N and O).

Why have consumer groups chosen to fight this battle at the Federal level?

The simple fact of the matter is that this is the only place where we can attack the problem because, in almost all cases, we are dealing with an expense that is largely beyond the local control of utilities and public utility commissions (PUC).

Coal transportation rates are not a profit item for utilities. They do not profit from raising or lowering coal transportation rates. A reduction in rates would be passed through to consumers. There are only a very few cases in which utilities could even contemplate increasing their profits as a result of a reduction in transportation costs and those would be vigorously challenged at the state level.

In the overwhelming majority of cases we are dealing strictly with an expense item. Since transportation rates are regulated at the federal level, it is difficult, if not impossible, to go before state public utility commissions to blame utilities for transportation rates that are excessive. The ICC is the culprit and it is only before the ICC and Congress that we can confront the problem.

Has the problem of captive shippers influenced recent railroad legislation?

Yes, and it is very important to keep the context of the captive shipper in mind. Because of the existence of captive shippers, Congress was forced to engage in regulatory reform in the railroad industry rather than total deregulation (See Appendix I).

Between the end of the second World War and the late-1970s the railroad industry posed a serious public policy dilemma. While much of the industry was quite healthy, a number of railroads were in dire financial straits. Although there were many causes of the difficulties of specific railroads—including a shift in the geographic distribution of activity within the economy, the completion of the interstate highway system and the growth of air travel—in the early 1970s the conviction arose that a significant part of the problem stemmed from federal regulation of the railroads.

Two major pieces of legislation were passed in an effort to render the railroad industry more flexible and efficient. The Railroad Regulatory Reform and Revitalization Act of 1976 (The 4R Act) may ultimately be identified as the first step in the general regulatory reform movement of the 1970s. The Staggers Act of 1980 carried the reform of railroad regulation much farther.

Throughout the reform process Congress recognized that it was important to ease the regulatory burden on railroads in a careful manner. Thus, it moved vigorously to deregulate in those areas where advances in transportation technology had led to the growth of competition. Here it was felt that regulation inhibited efficient operation of the railroads and retarded effective responses to the dynamically changing transportation market.

In other areas Congress moved much more cautiously. In the regulation of rates for bulk commodities—particularly coal—it expressed a concern that market forces were weak and could not create efficiency. Unlike most other aspects of railroad regulation, the need for maximum rate regulation of bulk commodities rests on the recognition that the railroads continue to have monopoly power over the transporta-

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tion of bulk commodities. The potential for unfair and inefficient rate increases was recognized and provisions were included to prevent such abuses.

What captive shipper protections were included in the Staggers Act?

The captive shipper provisions in the Act are intended to ensure that the creation of a financially viable and economically sound rail network is achieved in an equitable and efficient manner. The Act identifies revenue adequacy as a primary goal and allows differential pricing—price discrimination—in pursuit of that goal. However, neither the revenue adequacy principle nor differential pricing was intended to be a blank check. Congress expected that some price discrimination would exist in the railroad industry, but it also intended to keep such price discrimination to a minimum.

It allowed for a flexible jurisdictional threshold.

It stipulated that management had to be honest, economic and efficient.

It required the elimination of noncompensatory traffic.

It required the maximization of revenues from competitive traffic.

It stated that even in the quest for revenue adequacy the burden on captive commodities, such as coal, should not be onerous.

It recognized that the goal of energy security is a competing national priority.

The "pay-off" to consumers for bearing the burden of some differential pricing was the prevention of excess profits through the revenue restraint embodied in a revenue adequacy test.

Vigorous implementation of realistic revenue adequacy tests and efficiency criteria, combined with the Long-Cannon factors which mandated the sharing of the burden of revenue adequacy, should have controlled the revenue requirement of the railroads and the burden placed on coal and all shippers.

Why have these protections been ineffective?

Unfortunately the ICC has instituted accounting procedures and revenue adequacy standards that make it impossible to establish the level of inefficiency and cross-subsidy present in railroad operation or to ascertain in a reasonable fashion when specific companies are revenue adequate. The ICC never ensured application of the Long-Cannon factors. The extent of price discrimination justified under the regulatory scheme that Congress intended in the Staggers Act would have been smaller than currently exists. However, because that scheme was never implemented, at present it is impossible to distinguish between justified price discrimination and abuse of market power.

The result has been a breakdown of the underlying logic of regulatory reform. The major coal railroads are economically sound, but that fact has not been allowed to play its proper role in the regulatory process by restraining rates. Rates for coal are held far above costs under the illusion that the railroads are revenue inadequate, when in fact, several are more than revenue adequate. This gives the railroads hordes of cash to play with. Some has been funneled off into acquisitions. Some has been used to absorb inefficiencies—keeping the capital stock inefficiently large or offsetting the failure to increase revenues from competitive traffic or to eliminate non-compensatory traffic. In all cases, the result is an excessive burden placed on monopolized shippers and captive consumers.

How have you documented these problems?

In our research we reviewed policy analyses of the railroad industry over the past decade, evidence introduced before the ICC and the courts, financial analyses from Wall Street, and data on the operations of the railroads. We have documented the basic conditions of an unrestrained abuse of market power.

Prices are high and rigid—evidenced in the failure of prices to reflect fundamental changes in cost conditions (see Appendix J).

We observe the structural conditions for market power—an absence of competition and high concentration ratios (see Appendix K).

Behavior aimed at preserving and expanding the market power of dominant firms in the industry is quite apparent—evidenced in the effort to foreclose entry by intramodal and intermodal alternatives, as well as intramodal concentration and intermodal integration (see Appendix K).

Excess profitability is apparent in the form of huge spin offs of monopoly profits into other industries (see Appendix L).

From the electric utility consumer's point of view we conclude that:

Electric utility bills already bear a heavy burden of price discrimination.

The railroads are obviously healthy and those that are taking the lion's share of the monopoly rents probably never needed much recourse to the extraordinary measure of price discrimination.

In spite of this, the regulatory agency charged with protecting consumers has constructed an economic and accounting fiction that finds every railroad revenue inadequate. Its maximum rate guidelines would impose virtually no regulatory restraint on railroad pricing practices. The result is entirely unreasonable.

Even if one deems the current level of price discrimination justified, there can be little justification for further price discrimination, but the ICC cannot be expected or trusted to prevent future abuses. Only Congress can effectively address the problem through legislation.

What is the problem with the ICC's revenue adequacy test?

The ICC believes that the railroads are desperately short of revenue. It maintains that the major coal hauling railroads—the Norfolk Southern, the Burlington Northern, the CSX—would have to double their profits to be revenue adequate. We do not believe that and nobody else does.

We look at the multibillion dollar acquisitions of these companies; we look at their performance on a variety of indicators including return on equity, sales growth and profitability; we look at their bond ratings, and we conclude what stock buyers and bondholders, and even the Department of Transportation in the case of one railroad, have concluded—these are highly profitable corporations that are not experiencing any financial difficulty whatsoever. In the case of most of the major coal hauling railroads they have not experienced such difficulties in at least a decade.

How do you propose to fix the revenue adequacy test?

We propose two steps. First, because it is so central to the functioning of the law, we believe that the revenue adequacy determination must be opened up to closer public scrutiny. As currently constituted the ICC simply gets together with the railroads and decides what the revenue requirement is. We would like to see the ICC justify its determinations and to have the opportunity to at least comment. This is actually somewhat less than we get at the state level and before other federal regulatory agencies, but it will be a help.

Second, and more importantly, we believe it is crucial to apply the accounting procedures and concepts that are applied by virtually every other regulatory body in the nation. The use of net book historical costs, the preclusion of a return on deferred taxes, the use of embedded cost of debt, and a focus on return on equity, are the common practices that are applied not only in regulated industries, but in unregulated industries as well.

Financial analysts look at a range of economic indicators when evaluating companies. Public utility commissions look at a range of financial indicators when deciding which companies should be selected for comparison purposes in determining a fair rate of return.

There must also be scrutiny of the investment base and management practices of the railroads. The Staggers Act stipulated such conditions, the ICC has yet to do anything to assess the performance of the railroads in these regards.

Are these diverse criteria recognized as indicators of financial viability within the railroad industry?

Less than six months ago Howard William Brown, Vice President and Treasurer of Consolidated Rail Corporation (Conrail), stated the following (see Appendix P, in which the quoted portions are underlined).

As a railroad financial officer, I am familiar with the financial criteria by which to assess the long-term viability of projected expansion of operation such as those proposed by Guilford Transportation Industries (Guilford) and the Pittsburgh and Lake Erie Railroad (P&LE). The purpose of this statement is to discuss these criteria and to provide some analysis of the proposed divestitures, as this study is the first formal opportunity for such an examination.

The financial criteria fall into three categories. The first category covers general financial factors that bear on the ability of a company to withstand financial downturns and support acquisition and capital programs. Analysis of these factors requires detailed historical financial data as well as financial projection and plans for financing. Second there are ratios based on investment and financial results, that measure financial health. Third, there are ratios indicating operating efficiency and productivity . . .

Turning to the analysis of available information, financial health can be measured in three major ways; by assessing (1) profitability; (2) leverage; and (3) liquidity . . .

Ratios showing profitability measure the overall effectiveness of a firm's management. These ratios are often used by investors to compare the attractiveness of investment . . .

Leverage ratios measure the strength of a firm by looking at the sources of financing available to it and the risks of each source. Equity financing, such as common stock or retained earnings, is the least risky for the firm since dividends are not fixed legal obligations. Debt financing is most risky because interest payments are legal obligations and failure to meet them can result in involuntary bankruptcy . . .

Liquidity ratios measure a firm's ability to meet short-term obligations and to withstand recession, or other cyclical downturn, strikes, etc.

I am certain that if Mr. Brown were here today he would argue that different criteria should be applied for purposes of revenue adequacy, because the circumstances are different, but frankly, we believe that the "ratios often used by investors to compare the attractiveness of investment" and the criteria used by railroads to assess long-term viability should be of considerable relevance to the revenue adequacy test. Mr. Brown cited a number of different measures in each of the three above mentioned categories. I might add that CSX cited similar sets of measures.

Have you examined the financial performance of the major coal hauling railroads in these terms?

Yes, one of the studies we conducted focused on the financial performance of the major coal hauling railroads (See Appendix L). When one observes that the parent companies of the major coal hauling railroads (CSX, BN, UP and NS), who derive the bulk of their sales and profits from rail operations, are performing about as well as the largest corporations in the nation, one comes to appreciate just how absurd the ICC's revenue adequacy test is.

Based on the most recent survey of business performance conducted by Forbes Magazine, which covers the largest 1000 corporations over a five year period, I concluded that the major coal hauling railroads did somewhat better than average on net profit margin and sales growth and somewhat worse than average on return on equity and earnings per share. It is just impossible to look at these figures on financial performance and conclude that the income of these companies would have to double in order for them to be revenue adequate.

Looking at their debt position, we find that the industry as a whole had somewhat higher debt ratios than the average company, but much lower debt ratios than business which have significant monopoly segments—natural gas and telephones for example. In 1983 every rail subsidiary of the major coal hauling railroads had a bond rating of A or better and most had ratings of AA. The Business Week scoreboard of June 24, 1985 showed that the parent companies of the four major coal hauling railroads had debt ratios well below the national average and fixed charge coverages well above the national average, while current ratios were somewhat below the national average (See Appendix Q).

Again, in light of these highly positive indicators, it is just impossible to conclude that their financial condition is as poor as the ICC maintains.

Have you examined the operating performance of the major coal hauling railroads?

Yes. A second major thrust of our analysis was to examine the increase in freight and revenue per mile of track (see Appendix J). This was one of the major criteria proposed by Mr. Brown. Moreover, the analyses of the railroad industry, conducted during the late 1970s and based on data from the early and mid-1970s indicated that freight density was the key to financial viability for the railroad industry. Changes in density since then clearly indicate they must be approaching revenue adequacy.

Since 1975, for example, coal freight densities, measured by increases in net ton miles carried per route mile, have more than doubled. Since coal rates covered their costs before this growth began, and economies of density existed over the range of increase (although they may have now been exhausted), this suggests an astronomical increase in profitability. Looking across all freight, I concluded that not only are some railroads revenue adequate, but that excessive cash flows are being generated to fund acquisitions.

On what basis have you concluded that coal is an extremely profitable commodity for the railroads?

The third of our major studies looked at the general relationship between costs and rates for transporting coal. We reviewed evidence on the existence of market power and its actual exercise. These included both econometric studies of the extraction of monopoly profits by railroads on coal transportation and accounting studies of the cost of moving coal for individual carriers and for the industry as a whole. We concluded that, at present, price discrimination has resulted in rates that are, on average, 30 percent above costs.

Interestingly, the thirty percent figure is quite consistent with recent developments in the Powder River Basin, where the advent of real competition seems to have lowered rates by at least 30 percent. The one case of new intramodal competition coming to the coal transport industry has wrung the 30 percent monopoly profits out of the trade. The Chief Economic Officer of Conrail recently said that the presence of competition in the East lowers rates by 30 percent.

Have the railroads or the ICC responded to your studies?

The railroads issued two responses to the studies, one in April and one in July. I have rebutted all of the criticism in detail (see Appendices Q and R). My conclusion stand.

To summarize the response, I find that both sets of railroad criticism either misstated our argument or misapplied it. They claim that we are against differential pricing, which we are not. They simply ignore the real world evidence (i.e. non-ICC evidence) on financial viability. They look at average industry income, which obscures the fact that some railroads are, and have been, very healthy, while others are not. They have misapplied my methodology for estimating the extent of price discrimination.

Perhaps the single greatest point of contention between us and the railroads revolves around the profitability of coal transportation. We draw a direct line in the real world behaviors of the railroads from highly profitable rates for coal traffic, to high rating in the financial markets, to huge flows of excess cash for acquisitions. We simply avoid the accounting fiction that the ICC has created.

The railroads maintain that so long as the overall "profitability" of the railroads is not satisfactory, than no rate is too high, since revenue adequacy has not been achieved. The ICC's coal rate guidelines seem to endorse this position.

The problem is that the revenue adequacy test has cooked the books. It attributes a level of revenue need to the railroads that is simply out of touch with reality. We're convinced that if the revenue adequacy test were reasonable, the extremely high profitability would be apparent.

For its part, the ICC suggested in October—six months after the studies were published—that it could not find an audit trail supporting our results. Frankly, no one at the ICC ever asked for an audit trail and the ICC has never published or made available to me any specific criticism our analysis. I will be glad to respond, as I have done with the railroad analysis, if they will state what they find objectionable or unclear.

What is the problem with the ICC's maximum rate guidelines?

Even if the ICC had gotten the revenue adequacy determination correct, the guidelines it has adopted for setting maximum rates would be unacceptable. The ICC has proposed two wonderfully vacuous theories for maximum rate guidelines—stand-alone-cost and Ramsey pricing. They are theories of the highest order—in theory they are correct, but in practice they are useless. The ICC goes so far as to admit it.

One theory, it admits is so difficult as to be impossible of application; the other, by its very assumptions, is not applicable to the industry. The ICC's response is to try to take two wrongs and turn them into a right.

The ICC says that Ramsey pricing is just too hard to do. Moreover, it states that if any could do it, the railroads should be the ones. The ICC is willing to give the railroads the benefit of the doubt, however, and just assume that, if they do apply Ramsey pricing, they must be doing it right. No showing will be required by the railroads.

If shippers don't like to outcome, they have to make a showing that the railroads are not properly applying the principle of Ramsey pricing. This is the same principle which the ICC said no one can apply or at best the railroads have the information to apply. You can appreciate why the captives in the system are skeptical that this rule will provide adequate protection.

The theory of contestability—and its offspring, stand-alone-cost—is just inapplicable. It rests on the assumption that there are no barriers to entry and exit—above all that there are no sunk costs. Of course, the railroad industry does have large sunk costs, but the ICC says, we will take care of those costs in a massive regulatory proceeding in which shippers are called on to prove that they can build a hypothetical railroad for less than the rate the actual railroad wants to charge.

In the real world, in those instances where contestability was actually supposed to work—like the airline industry—it has failed in exactly the area where the ICC hopes to make it succeed—disciplining rates (see Appendix S). The overwhelming empirical evidence is that contestability does not discipline or prevent the exercise of market power, only real competition does.

Worse still, it turns out that even in theory, the combination of assumptions that is necessary to make it a logically correct set of statements are very restrictive (see Appendix T). If you violate key assumptions, the theory breaks down and the key assumptions are least applicable to the railroad industry.

When an agency proceeds with theories that don't fit; admits they are difficult to apply; and puts the burden of proof not on the monopolist but the captive, there is little protection from the abuse of market power. This is the source of despair that complainants and judges have expressed.

What approach do you propose for ratemaking?

Again, our legislation stresses the process, not any specific formula. Keeping in mind that the purpose of these provision is to protect those who are at the mercy of the railroads, we have proposed a number of steps.

First, fixing the revenue adequacy test will go a long way toward solving the problem.

Second, we propose to shift the burden of proof from the shipper to the railroads. In virtually every other ratemaking at the federal or state level, the party requesting the rate increase bears the burden of proof. The railroad has the market power and the incentive to abuse it, therefore the monopolist should bear the burden of proving that a rate is reasonable. The railroads also have the data which is necessary to justify a rate. Although no company ever puts all the data on the table, by bearing the burden of proof they are forced to reveal the most important elements of cost and price information. It should be stressed that the burden of proof only applies above the jurisdictional threshold, which we have not proposed to alter. Thus, we are not proposing to expand the scope of regulation of rates, we are only proposing to shift the regulatory burden to the party requesting the rate increase.

Third, we are placing greater stress on getting the pricing of competitive traffic correct by moving the Long-Cannon factors into the ratemaking proceeding. This is, in fact, the way it is done in other industries where there are mixed monopoly and competitive services. Companies with mixed services have an incentive to maximize revenues from and shift costs to the monopolized services first, since it is less risky. The regulator, in his function of protecting the captive consumer, should lean in the opposite direction--ensuring that the monopolist maximizes revenues from competitive services before collecting the residual from his captives.

Finally, the relationship between actual costs and prices must be considered. This does not mean that only cost can be considered in ratemaking or that costs must be the only basis for rates. Indeed, in industries where there are economies of scope (joint production) costs never are the only basis for ratesetting. The hypothetical cost relationship on which the ICC proposes to base rates—the fact that a rate is below the hypothetical cost of building a new railroad—will never convince shippers that they are being fairly treated.

The concept of equity that underlies the theory of stand-alone-cost as applied by the ICC is simply unacceptable. As I pointed out in my filing in Ex Parte 347 (see Appendix D) and recently reiterated in testified before the Energy and Natural Resources Committee (see Appendix U), this is a minimalist concept of equity.

Suppose you find that you are paying a dime less than it would cost you to build your own railroad. Is that fair? According to the ICC, as long as you are getting some reduction below hypothetical stand alone cost, the rate is reasonable. But what if other shippers are paying $1.00 less than it would cost them to build their own hypothetical railroads? And what if the real railroad could be revenue adequate if everyone's rates were $.55 below their respective stand alone costs? Wouldn't that be fair to all parties. Who saves the dime and who saves the dollar? Stand-along-cost is useless on this matter, as the ICC uses it. The ICC has abandoned the issue, leaving it to the discretion of the railroads. Why shouldn't both parties share the cost burden more equally?

Although you maintain that your proposals apply standard practices to the railroads, the railroads say that you are treating them differently than electric utilities. Is this true?

No. The simple fact is that both the electric utilities and the railroads are industries that have considerable market power and will do the best they can to profit by exercising that market power. As a consumer group, we oppose many of the things that both industries try to get away with. The fact that the railroads have mounted an attacked on the electric utility industry and its regulators is remarkable, since the rules applied by the ICC to the railroads do much more to abuse the consumer than the rules applied to electric utilities by any other federal or state regulatory body.

The case of the railroads complaining about what the electric utilities ask for, or in some cases get away with, is not simply a matter of the pot calling the kettle black. It is much worse than that, since most public utility commissions have scoured the kettle out a bit, whereas the ICC hasn't even tried to wash the pot.

This point can be made most directly with respect to an opinion piece that Frank Wilner, an Assistant Vice President of the American Association of Railroads, recently wrote in the Oregonian (October 15, 1985; see Appendix V), a paper of some importance to at least one member of this Committee. A similar argument, with a great deal more vitriol, was made by Mr. Dempsey, President of the AAR, at a press conference on July 22 (See Appendix W). In all, they complain about six things, utility taxes, inefficiency in the investment base, electricity rate increases in excess of inflation, utility achieved rates of return, diversification, and denial of competitive access.

What is the problem with the tax treatment of utilities?

Mr. Wilner's first complaint is that "electric utilities billed their customers for $7.4 billion in so-called "phantom" taxes in 1984."

We don't like phantom taxes either. We have worked hard to have Congress eliminate them. In fact, we testified before Congress just last year on this matter (see Appendix X) and, as recently as two months ago, we wrote to Congress to eliminate the problem (See Appendix Y).

What Mr. Wilner fails to point out is that the treatment of taxes by the ICC is even worse than the regulatory treatment of electric utility taxes. Not only does the collection of taxes which are not actually paid enter into the revenue requirement for pupoees of determining revenue adequacy, but the ICC adds a rate of return on those deferred taxes. No other regulatory body does so because it is simply absurd to treat money collected from captive consumers for purposes of paying taxes, which aren't actually paid, as capital.

We are working very hard to take care of the phantom tax problem in the tax reform measure being marked up in the House Ways and Means Committee. When that measure comes over to the Senate, we urge all of you to work with us to solve the problem.

However, this Committee has a similar inequity before it today. It doesn't have to wait for the House to act. What we have proposed only eliminates the return on deferred taxes that the ICC puts into the revenue requirement. We urge you to fix that problem here and now.

What is the problem with the investment base?

Mr. Wilner's second complaint is that customers of a number of utilities across the country are being billed for billions in failed investment in terminated facilities and that public utility commissions "have permitted utilities to recover from customers virtually all costs associated with poor management decisions."

We don't like utilities recovering these costs. In fact, we urge that public utility commissions adhere to a strict standard of used and useful. We have worked hard with the Congress to pass least-cost planning legislation (see Appendix Z).

Mr. Wilner fails to point out that the ICC simply ignores the question of the rate base and that the railroads have benefited from a dramatic write up of the rate base in recent years. In fact, the studies I examined of the railroad financial condition and operating efficiency showed that reducing the capital stock was the key to economic viability. Unfortunately, once the railroads are given a free hand by the ICC to increase rates for captive shippers, they lose the incentive to eliminate investments that are not used and useful. In my 347 comments I stressed the need to create incentives to ensure that only an efficient ratebase is maintained (see Appendix D).

I am certain that a comparison between the ICC's scrutiny of railroad management decisions and public utility commission scrutiny of electric utility management decisions would show that the PUC's have been much harder on electric utilities than the ICC has been on the railroads—although I would agree that they have not been hard enough.

Moreover, to set the record straight, a comprehensive study of cancellation and abandonment costs conducted by the U.S. Department of Energy found that PUCs had not passed "virtually all costs" through to consumers—they had forced stockholders to bear about a third of the burden and taxpayers had picked up another third (see Appendix AA). Since that study was conducted in 1983, it is my impression that PUCs have gotten a little tougher.

We urge those of you who serve on the Energy and Natural Resources Committee to help us move least cost legislation. However, this Committee has a similar problem before it and it does not have to wait for anyone else to act. What we are proposing is not as strong as the used and useful principle applied elsewhere, but it will be a help. We urge you to fix it here and now.

What is the problem with the inflation comparison?

Mr. Wilner makes a point of noting that "between January 1982 and October 1984, according to Edison Electric Institute data, average national electricity rates rose almost 21 percent—or about twice as fast as inflation."

We don't like price increases, whether they are greater than or less than the rate of inflation, if they are not justified by cost increases. Most monopolists can always find some date in the past to show that their rates are going up slower than the rate of inflation, or that some other industry's prices are going up faster than the rate of inflation.

Such comparisons are pure deception. Price increases should be justified not by their comparison to the rate of inflation, but by comparison to the underlying costs of providing service. We measure the exercise of market power not by the absolute level of prices, but by the rate of profit. If the costs of delivering a service or producing a commodity are falling we expect the price to fall also, regardless of what the general rate of inflation is doing.

In our first communication with the Congress on this matter we emphasized profitability. After pointing out that rail rates had been rising much faster than the rate of inflation in the decade prior to passage of the Staggers Act, we said in supporting the Long amendment,

Although S. 1946 encompasses some recognition for the problem posed for captive shippers, many of its provisions will allow railroads to increase their profit taking over existing levels whether or not current rates already provide more than adequate profits.

We urge the Committee to focus on the real costs of providing service and on the profitability of various services, not the rate of inflation in general, or for any specific commodity.

What is the problem with diversification and spin offs?

Mr. Wilner comments that a number of utilities are using "excess cash to pay higher dividends and invest in manufacturing, land development and high technology."

We are deeply concerned about the huge cash flows generated by electric utilities and have fought to preserve those structures that enable regulators and consumers to monitor and, where necessary, control such developments. As recently as a month ago we wrote to the Senate to preserve the Public Utility Holding Company Act (See Appendix BB).

Mr. Wilner fails to point out that railroads have engaged in a most remarkable spree of acquiring non-rail assets. Virtually all of the buying is being done by the major coal hauling railroads (CBX, BN, NS). These three alone have acquired, or are in the process of acquiring almost five billion dollars in assets in a four year period. Compared to their asset base, they are diversifying at a rate that makes the electric utility industry look like it is moving at a snail's pace.

The railroads, the ICC and the DOE originally tried to reconcile the excess cash and the acquisition with the argument that the railroads are a mature industry whose rate of return is not high enough to hold capital in it.

We believe that there are other explanations that are at least as plausible. These are the same explanations that we give when we testify about other partially regulated industries that have an excess of cash

If the allowed and achieved rate of return is higher than necessary to attract capital, given the risk of the industry, it will generate an excess of cash. If the investment base used to calculate its rate of return contains assets that are not used and useful in provision of service, it can generate an excess of cash. If the depreciation schedule for the assets that are used and useful is too short compared to the economic life of the assets, it will generate an excess of cash in the early years and a strong incentive to revalue assets in the latter years, which again creates an excess of cash.

Do we look at the tremendous cash flows, strong stock market and bond performance of these railroads and conclude that they are part of a poor mature industry, as the ICC says, or part of a perfectly sound financially healthy industry, as just about every other financial analyst and regulator in the country would conclude.

Recently the railroads and the ICC have tried another explanation for the hordes of cash laying around in railroad treasuries. They say these are tax benefits. The three large railroad parent corporations that are doing all the acquiring had a combined tax rate of about 3 percent since the Staggers Act (according to a study by Citizens for Tax Justice, see Appendix CC). That is the "phantom tax problem" with a vengeance. In the electric utility industry, some of the deferred taxes will be passed back through to ratepayers. The way the ICC accounts for these holding company transactions, funds which were generated in rail operations but pass on to non-rail holding company acquisitions do nothing to reduce the revenue requirement placed on future consumers of rail services.

Although we have not proposed specific legislation for the railroad industry, we call the attention of the members of the Committee to the current spin-off movement in the railroad industry. We are not against diversification, as such, nor are we against stockholders making the highest return on the money that they can. But let us recall that Congress has granted the railroads a unique power. It allowed the railroads to set prices far above costs in circumstances where they have market or monopoly power. It granted this extraordinary power in pursuit of a specific social goal—a financially sound railroad network. Did Congress intend that consumers of coal pay for the purchase of airlines, natural has companies, and barge and truck lines? If the social purposes for which Congress granted the right to price discriminate are being perverted, it has every right to reconsider the grant.

What is the problem in the discussion of return on equity?

Mr. Wilner also complains that a particular utility in Oregon has increased it earnings and made a return on equity of just over 15 percent in 1984 in an industry that hasn't experienced a bankruptcy in over 50 years.

Mr. Wilner fails to point out that utilities are only allowed their actual cost of debt, whereas the ICC utilizes the current cost of debt in calculating the revenue requirement and a much higher percentage of equity in the debt/equity mix. This is in addition to the inflation of the investment base against which the ICC estimates revenue requirements.

The bottom line is that the regulatory treatment afforded the railroads by the ICC is ridiculously generous to the railroads. Both private and government studies have shown that it overstates the revenue needs of the railroads by a factor of two. I am certain that every utility—electrically, natural gas, telephones, water systems—would love to have the regulatory treatment that the ICC affords the railroads. But that does not make it right.

We fight against excessive rates of return and overly generous accounting practices for utilities at the federal and state level. We advocate one set of principles for all monopoly services. There are many problems which the Energy and Natural Resources Committee could address, what we are asking you to do here and now is to set the ICC accounting practices and procedures on a par with the rest of the nation.

What is the problem with competitive access?

Finally, Mr. Wilner complains that "the captive customer of the local electric company bears all costs and risks—and cannot seek another supplier to make a better deal for himself."

We are very much concerned about the problem of access to alternative suppliers. Since distribution and transmission appear to be bottleneck facilities or natural monopolies, for years we have supported vigorously the concept of wheeling in the electric utility industry and contract carriage in the natural gas industry. In fact, within the past several months we have written to Congress on both of these matters (see Appendices DD and EE).

Mr. Wilner fails to point out that there is no mechanism to ensure such competitive access in the railroad industry. He talks of a contestable market—but no one believes that electric transmission and distribution is contestable and even the ICC admits that the railroad industry is not a contestable market for captives because of sunk costs. Contestability in these industries, without rigorously ensured open access, is a sham, a license to steal. It removes the protections of regulation under the pretext of allowing either competition or contestability to provide protection. For captive shippers, neither competition nor contestability can exist unless open access is rigorously enforced.

We urge the members of this Committee to support procompetitive structures for all transportation and communications industries, as we have. The Committee has a specific problem in the railroad industry before it and it need not wait for anyone else to act. We urge you to fix that problem here and now.

Summarize your conclusions about the implementation of the captive shipper provisions of the Staggers Act and your proposed changes?

If there is any double standard being proposed to this Committee, it lies in the fact that the railroads are being treated too leniently in the proposed amendments to the Staggers act.

The jurisdiction threshold remains at a revenue to variable cost ratio of 180 percent. That implies a level of differential pricing not subject to any regulatory oversight that may actually be more than some railroads need in order to achieve revenue adequacy, but a reasonable test.

The standard for scrutinizing the investment base is not the fully used and useful standard. The rules for competitive access are much less stringent than we have advocated for electricity or recently won for natural gas.

What we have proposed is to level the playing field so that captive consumers and shippers have a reasonable chance of getting some relief. Defenders of the Staggers

Act frequently argue that a compromise was struck and it should not be reopened. The truth is that the compromise existed in the law, but not in its implementation by the ICC. The ICC has undermined the compromise by tipping every scale in favor of the railroads. We believe that Congress, and only Congress, can restore the balance by shifting the burden of proof and stipulating a few fundamentals for establishing revenue adequacy maximum rates.

I appreciate the opportunity to appear before the Committee and look forward to working with the members in developing effective solutions to these pressing consumer problems.

Senator PACKWOOD. Thank you.

Mr. Hertog.

Mr. HERTOG. Thank you, Mr. Chairman, for this opportunity to appear before the committee and for accepting the statement that I filed earlier as part of the committee's record. My remarks are going to be brief.

In 1980, the Staggers Act was passed by Congress, and basically it seemed to say to the railroads, get out and compete. It offered opportunity, but it did not offer a guarantee. It provided safeguards, we think, against abuse, and where are we at this point in time?

I think since the Staggers Act has passed, we can clearly state that competition between railroads and between railroads and other modes has intensified. The average prices charged for transportation in real terms are less than they were in 1980. The Interstate Commerce Commission has fewer disputes, and much of the traffic moving today, and on today's railroads move under contracts that were negotiated through arm's length bargaining sessions.

And last, we believe, notwithstanding the criticism we hear, that there is in fact reasonable protection in place for the captive shipper. Rail carriers are stronger and service is better. The goal section of the Staggers Act in section 3, I think, was quite clear, and bears repeating. There were five goals specifically stated.

No. 1, to assist the railroads in rehabilitating the railroad system, and to recognize at that point in time that the rail system was in fact in need of considerable rehabilitation, and that that was in the public interest.

No. 2, to reform regulatory policy in order to create a healthy railroad system. No. 3, to assist the railroads to remain viable in the private sector. No. 4, to provide a regulatory process that balances the needs of the carriers, shippers, and the public.

And No. 5, to assist in rehabilitating and financing the rail system. I would say that that is exactly what has taken place since the Staggers Act has come into being, and just as there have been differences on joint rates, on questions of market dominance, on questions of reciprocal switching that have been negotiated between the AAR on the one hand on behalf of the railroads and various shippers' interests, it seems to me that other issues to the extent there continue to be differences can also be negotiated. I would urge that that be the process that be followed, not tinkering with the basic legislation itself.

Briefly, in response to my colleague at my right, we at Burlington Northern are proud of the record that we have achieved. We have achieved it primarily through becoming more efficient. We have reduced our work force by some 33 percent over the last 4 years. We think that we need to become even more productive. That is how we have done it.

Thank you. I will be happy to respond to any questions you may have.

[The statement follows:]

STATEMENT OF JOHN H. HERTOG, SENIOR VICE PRESIDENT, COAL & TACONITE, BURLINGTON NORTHERN RAILROAD CO.

Mr. Chairman and Members of the Sub-committee, I am pleased to appear before you with regard to the Staggers Rail Act of 1980 and its implementation. My comments will be only on behalf of Burlington Northern Railroad Company which operates the largest railroad system in the U.S. in terms of miles of road. Our system consists of 28,000 miles of track serving the Midwest, the Pacific Northwest, the mid-South and the Gulf Coast. My area of responsibility is mainly in coal which comprises 41% of BNRR revenues and 56% of our volume, so my testimony will focus on that commodity. Most of our coal traffic is moved by unit trains from the Powder River Basin in Montana and Wyoming to forty-five electric utility plants throughout the U.S.

INTENT OF STAGGERS ACT

The reform wrought by Congrss in the Staggers Act were in response to an impending disaster in a vital portion of the country's transportation infrastructure. Without Congressional intervention, our U.S. railroad system would likely have been in shambles before now, especially with the added factor of slow economic performance of the last several years.

I don't think there can be much doubt that the Act has accomplished its purpose. The nation's railroads—while not the most financially robust of industry groups—nonetheless earned a respectable 5.7 percent return on investment in 1984 according to the Association of American Railraods. More importantly, these earnings allowed the industry to make capital expenditures of about $3 billion in plant and equipment to ensure the viability of this country's railroad system. My company has followed this post-Staggers industry pattern of increased investment from improved earnings with our 1984 investments in track and equipment totaling nearly $700 million—about 60 percent more than in 1980. Within the deregulated environment created by the Staggers Act, we have been able to bring earnings up to levels that provide a fair return on the massive investments we have been required to make to handle our coal traffic and still improve our physical plant and equipment.

REVENUE IMPROVEMENT

Our financial improvement has come from two directions: increases in revenues and very strong increases in productivity. Prior to 1981, we found ourselves in a position where, in many instances, we could not charge prices for our service sufficient to earn an acceptable return on investment because of "caps" imposed by the Interstate Commerce Commission Commission in a variety of inconsistent, often conflicting decisions. This was true for coal as well as other commodities. The Staggers Act effectied a semi-regulated framework wherein railroads could gradually raise rates up to a level generally approximating 180 percent of variable cost, which is the minimum deemed necessary to earn returns adequate to attract continued investment in the industry. Moreover, the legislation allowed increases in rates each quarter to keep up with cost increases we experience.

The result of this rate "freedom" is probably not at all what you might expect. BN Railroad's average cost rates did, in fact, increase, 1980-1984, from 1.15¢ per ton mile to 1.67¢ per ton mile—a change of 45 percent. It must be noted, however, that our costs as measured by the AAR Index (Western District), increased 31% over the same period; that our coal rates were inordinately depressed at the start of the period, and that our increases have amounted to about 5 percent per year above inflation. Furthermore, we are now experiencing a decline in our ton-mile coal rate averages as a result of the very strong competitive pressures brought on by deregulation. Overall, however, our average revenue per ton mile for all commodities has increased only 1.8% in the more competitive environment since 1980, so it can hardly be said the Staggers Act provided us with much of a windfall.

IMPACTS OF BETTER PRODUCTIVITY

The improvements in our earnings since Staggers have not come so much from price increases as from the leverages of cost decreases. While our total revenues per ton mile barely increased from 2.18¢ to 2.22¢, our costs per ton mile dropped from 1.98¢ in 1980 to 1.75¢ in 1984—a decrease of 11.6 percent In order to respond successfully to the competitive parameters set up by the Staggers Act, we have made an enormous effort to improve productivity wherever and whenever we could, and are committed to being the low-cost carrier in our service territory. Our survival depends on being stronger, innovative more-productive managers.

Even in our already highly-efficient coal unit train operations we have made constant improvement in utilization of people, equipment and facilities without sacrifice of service to our customers. We have improved shippers' equipment utilization through better cycle times and increased loadings per car, and we are in constant touch with our utility customers to tailor our service to their needs for consistent, fast and flexible service. Many, if not all of these service improvements, which reflect themselves in lower costs for the utility companies, would not have been possible had the pre-Staggers' conditions prevailed.

ABILITY TO CONTRACT

Perhaps the most important provision of the Act for the future of coal traffic was Section 208 which allowed us the freedom to enter into transportation contracts to provide specialized services to our utility customers under specified rules and conditions. For the first time we were able to provide ourselves with long-term protection for the large capital investments we were having to make for coal. Prior to 1980, we operated on the assumption that we were not permitted to enter into contracts for coal transportation; now we have over two-thirds of our coal volume under long-term contracts negotiated since Staggers. These contracts reflect instances where we were able to reach agreements on mutually beneficial rate and service packages in arms-length bargaining. No regulatory body involvement, just straight-forward business agreements, many of which served to end costly and long-lasting litigation pending or active before the courts and the Interstate Commerce Commission. As recently as the first quarter of 1983 we were embroiled with our cutomers in 26 cases before the Commission and courts concerning coal rates; today we are involved in only 5 cases involving current movements, and those have a good chance of being settled by negotiations now underway.

Besides ending expensive litigation, the ability to contract is providing other important benefits to electric utility companies and their customers. The foremost benefit is lower freight rates. In return for long-term protection of our investment, we have been willing to accept rate levels well below what would be necessary if our investment were not protected. This was demonstrated two years ago by Cajun Electric Co-op of Baton Rouge, Louisiana, publicly claiming a $500 million freight saving to its customers as a result of the long-term transportation agreement it signed with Burlington Northern Railroad. I also believe that our contract movements of millions of tons of coal from Wyoming to the Gulf Coast area utilities such as Houston Light & Power, Gulf States Utilities and Cajun Electric Co-op speak directly to the effectiveness of our current rate structure.

Another significant advantage of transportation contracts for utilities is elimination of uncertainty as to freight costs. With a contract, a utility can be guaranteed a base rate as well as timing and amount of escalation. Often these agreements are tailored to match the term of mine contracts with similar price and escalation provisions thereby giving the utility significant cost stability on the fuel side of its generating operations.

NON EVIDENCE OF ABUSES

While there has been a good deal of public complaining on the part of some coal and utility trade associations and specially-formed advocacy groups, there does not seem to me to be much about the operation of the Staggers Act that has proved to be harmful to coal companies, electric utility companies or the average consumer. By and large, coal transportation is a better bargain for purchasers today than it was before the Staggers Act came into being. Certainly to the extent that electric utilities are dependent on a sound railroad system for most of their fuel supply, the power companies are better off than in 1980—and so are the industrial users of power, who also need a sound rail system. Even the U.S. Department of Energy, which is usually allied against the railroad industry on public policy issues, concluded in a recent study entitled, "Effects of Railroad Regulation Performance on Coal

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and Electricity", that the Staggers Act is working to the benefit of both the transportation and the energy sectors of our economy.

This is not to say that the Act is perfect either in concept or implementation. No doubt there are some utility companies who pay higher freight rates than others. And there are others who have low rates but wish to have still lower rates. The desire to have lowest possible costs is an economic fact of life. And for us the enchanced opportunity for competition for competition in some areas has resulted in reduced revenues and loss of market share.

Nonetheless, the Staggers Act seems to be working as it was intended and without any economic dislocations or impairment of functions of U.S. power generation. Any adjustments that need to be made here and there can be accomplished through negotiations between railroads and shippers groups or by Interstate Commerce Commission determination. I believe that almost any grievance we have with our utility or mine customers can be satisfactorily resolved through the negotiation process. I know that because I've been actively involved at such negotiation tables and I've seen it demonstrated over and over in the past several years.

With regard to allegations by special-interest groups concerning major "abuses" caused by the Act, I believe this committee should pay special attention to the studies by D.O.E. and our agencies which have found little, if any, evidence to suggest that deregulation has led to widespread price increases in relation to the underlying costs of rail transportation.

As a final comment on the subject of protections and benefits for the shipping public, I think it is important to remember that the Interstate Commerce Commission still exercises relatively strong control over the level of rates a railroad may charge for hauling coal. The Commission has over the past several years carefully developed a set of coal rate guidelines to establish a national economic framework that meets the twin imperatives of maintaining a healthy railroad system while protecting the producers and consumers of coal. This framework, while not perfect, does appear to be workable and appropriate to the accomplishment of our national transportation goals as well as our national energy goals.

SUMMARY

Before the Staggers Act, the U.S. railroad industry was in dire straits; and had that condition gone unremedied, the deterioration would inexorably have spread to the coal industry and the electric utility industry both of which depend heavily on rail transportation. Now, five years after the Act, the coal producers and utilities have a much healthier and more efficient railroad system to rely on and have the benefit of stable costs and contractual protections. In light of this record, there is nothing to warrant legislative change.

Senator PACKWOOD. Thank you.

Mr. Cooper, what was it that you said about Burlington Northern and 450 out of 1,000 in return on equity? I did not quite get your statement.

Mr. COOPER. Basically I went through a list of indicators of the relative performance of Burlington Northern and the 1,000 companies that appear in the annual survey of industry conducted at Forbes magazine. There is a series of indicators, and Burlington Northern outperformed about 450 of the 1,000 largest corporations.

Senator PACKWOOD. On what?

Mr. COOPER. On return on equity.

Senator PACKWOOD. So that 550 did better than they did?

Mr. COOPER. 550 did better. Then, of course, on the other indicators, Burlington Northern outperformed more than half of the other 1,000.

Senator PACKWOOD. But return on equity is a good standard?

Mr. COOPER. Return on equity is a good standard, absolutely. The question then is, is a performance right in the middle of those 1,000 companies indicative of a corporation that needs to double its profits? Suppose you would look at every other corporation on that list and apply the ICC's revenue adequacy standard. What you would

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have to conclude is that at least half and probably a lot more of the largest corporations in this country are revenue inadequate.

To me that is not a sensible conclusion for a rate-making or revenue adequacy——

Senator **Packwood**. Is the standard of revenue adequacy that the Interstate Commerce Commission uses the same one that State public utility commissions use?

Mr. **Cooper**. It is not for a number of financial and accounting differences, as I understand it. Certainly the ICC includes deferred taxes in the rate base. And therefore it allows the utility or the railroad in this case a return on that. Other regulatory bodies do not. Other regulatory bodies scrutinize the rate base. They exclude investments that are not used and useful. The ICC does not do that.

On those two points, at least, it makes a very large difference. A third difference is that other regulatory bodies do not use the current cost of debt. They use the imbedded cost of debt. The actual obligations that a utility has at a moment in time is a mix of old debt and new debt, and depending on how the rate of inflation is moving, the actual obligations you have will be different than your new obligations.

In the case of the railroad, that overstates the revenue requirement.

Senator **Packwood**. Let me ask you a further question. Most of us in Congress frequently use the Congressional Research Service, and find it pretty good. They do not have any ax to grind. They have not drafted any legislation. They do not have a stake in any policies. I am curious about their report, and I am quoting, "in terms of the railroads, the profit results still are not better than saving money in an interest-bearing checking account.

Such accounts yield about 5.2 percent. Is that an accurate statement? If so, is it an obtuse statement that somehow hides something?

Mr. **Cooper**. It hides a number of things. One thing—it is something that the ICC continues to do—is that is the average for all railroads, and we know that there are a number of very financially unsound railroads out there. Just look at what people are saying about the acquiring railroads in the Conrail divestiture.

The problem is that the major coal-hauling railroads do not have that kind of performance, so that average is completely misleading. You have to look at the individual railroad.

Second, that figure is based on these accounting peculiarities, if you will, at the ICC. These unique decisions that the ICC has said we are going to account, we are going to estimate revenue adequacy in this way.

Senator **Packwood**. You are saying the Congressional Research Service just took the ICC's definitions. It did not look behind them?

Mr. **Cooper**. I believe, and I have not had a chance to look, and I will be glad to give you a detailed analysis of what that document contains if it is written in a document, but it sounds to me as if they have simply adopted the revenue adequacy determination of the ICC, which says that Norfolk Southern has missed its cost of capital by 10 percentage points.

If you look at the financials of Norfolk Southern, there are almost—companies in this nation would love to have those numbers. So it sounds to me like they have simply adopted what I consider to be the accounting fictions of the ICC.

[The following information was subsequently received for the record:]

CONSUMER FEDERATION OF AMERICA,
November 18, 1985.

Senator ROBERT PACKWOOD,
Surface Transportation Subcommittee, Committee on Commerce, Science and Transportation, U.S. Senate.

DEAR SENATOR: Let me again express my deep appreciation for the opportunity to testify before the Committee on Surface Transportation on the implementation of the Staggers Rail Act of 1980 and for the opportunity to respond in detail to one of your questions which gets to the heart of the matters before the Committee. I applaud your efforts to sort out the plethora of conflicting statistics that have circulated in recent months.

My critique of the Congressional Research Service (CRS) study presented in this letter and the attached [1] memorandum should set the record straight once and for all on several of the most important points of contention between the Consumer Federation of America (CFA) and both the Interstate Commerce Commission (ICC) and the Association of American Railroads (AAR).

As I suspected at the time of the hearings, the CRS study to which you referred ("The Profitability of Railroads After Enactment of the Staggers Rail Act of 1980", May 8, 1985) is simply a regurgitation of statistics compiled by the ICC and the AAR.

The statistics and arguments of these two organizations have been adopted in the CRS study en toto. The study contains no critical assessment or analysis of the data and absolutely no consideration is given to any of the specific questions raised over the past several years about the accounting practices of the ICC and the analytic ploys of the AAR. As a result, the document is unbalanced, has little analytic value and certainly can not be a basis on which Congress can decide the important policy questions presented to the Committee at the hearings.

Consider the following examples.

The CRS study asserts that, because of their financial condition, the railroads have been forced to rely on debt to meet capital needs. In truth, the exact opposite has been the case. The industry has been reducing indebtedness and the major coal hauling railroads now carry less debt as a percentage of capital than the average large industrial corporation in the economy.

The CRS study relies on industry average income and profit figures, thereby obscuring the fact that the major coal hauling railroads are much more profitable than non-coal hauling railroads. Whereas the major coal hauling railroads (the Burlington Northern, CSX, and the Norfolk Southern) earned about 62 percent of the before tax profits and 53 percent of the after tax profits of all railroads, they have only about 45 percent of all rail assets and 35 percent of all rail debt.

The CRS study fails to note that in evaluating the financial conditions of the railroads the ICC uses accounting procedures applied by no other body in either the public or private sectors. These procedures overstate the revenue needs of the railroads by several billion dollars.

The study endeavors to reach conclusions about the profitability of the railroads and of the movement of specific commodities without ever analyzing the cost of service. Virtually every conclusion that the study reaches about profitability is reversed when cost conditions are considered.

After months, in some cases years, of chicanery on the part of the railroads and the ICC, the recent oversight hearings have put the spotlight on a small number of important flaws in the ICC's implementation of the Staggers Act—problems which were completely ignored in the CRS study.

I urge the Committee to move forward with legislative hearings so that a few, carefully targeted amendments can be enacted to remove the serious blemishes on an otherwise excellent piece of legislation. I hope that this critique of the CRS has clarified the issues before the Committee and I stand ready to assist it in any way possible in its deliberations.

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[1] The attachment has been retained in the Committee files.

Sincerely,

Mark N. Cooper,
Energy Director.

Senator Packwood. Now, let me turn to Mr. Flanders. The Department of Energy says, and here I am quoting their study, that "rail coal rates have increased only modestly, about 0.5 percent a year above inflation," and that, again quote, "no evidence that railroads have imposed abusive rates on coal since 1980."

Is there any basis for their statement?

Mr. Flanders. Well, again, as the gentleman just mentioned here to my left, I think they are using averages.

Senator Packwood. They are using averages.

Mr. Flanders. You will recall the specific numbers that I used in my case for our consumers, that has gone up over 200 and some percent in 5 years, and that is real facts. That is what has actually happened to us. We are paying better than double what all the other similar carriers in the west are paying.

Senator Packwood. What I am trying to find is whether we have just a few isolated horror stories. I am not saying because there are only 5 or 10 percent that are horror stories we do nothing, but I am trying to find out if it is 5 or 10 percent, or whether it is generic.

The Department of Energy comment would seem to say that on the average, coal-hauling rates have not gone up.

Mr. Flanders. That is what the report does say. We were one of the nine utilities that was included in that survey, and they have the real facts and the real numbers, and how they drew the conclusion they did is beyond me. I think there is more than 5 or 10 percent, Senator, of horror stories. There are quite a number of horror stories out there.

Senator Packwood. You were one of the nine they studied, and even with the extraordinary increases you had, they still came out with that average.

Mr. Flanders. Yes, sir.

Senator Packwood. Senator Long.

Senator Long. Mr. Flanders, did not the Staggers Act give the railroads the right to shut down service where it is not making enough money to justify the service? In other words, one of the things we did in the act was to allow them to discontinue service where they are losing money.

Mr. Flanders. Yes, sir. I don't really think there is anything particularly wrong with the Staggers Act, but you have to explain it to them with a bigger board. That is all you need.

Senator Long. It seems to me as though you are putting your finger right on the point. I supported the Staggers Act, and I am not complaining about these fellows coming in here all happy about it. No one is complaining about that. I am happy about it, too. We permitted the railroads, for example, to discontinue service in areas, as I recall it, where they are not making enough money to justify having the service at all.

We permitted the railroads flexibility in adjusting rates upward and downward to where they thought that would help their situation, rather than have them fool around with the ICC, and I am not complaining about all that. However, we could see that there are certain situations such as yours, the one that you just finished telling us about, where the railroads would be in a position to rape captive customers and captive shippers and captive consumers, and we tried to do something about that. I think the record will show that that was what we tried to do, but if you look at the way the ICC has handled the act, it simply failed to do the job. Is that not about the size of it?

Mr. FLANDERS. Yes, Senator, I think that is so. As I referred to it in my presentation, we won one battle. The administrative law judge said, yes, they should lower the rate, $10.88, pay reparations. That was a neat victory. They vacated the thing, and they raised the rates.

Senator LONG. Now, if the Commission had construed the law the same way that that examiner did, you would not be here complaining, I take it.

Mr. FLANDERS. No; we would not. If they could follow the Staggers Act, I think, as Congress intended, I do not think there would be that big a problem. They say talk to these railroads. Have you ever negotiated with yourself? I mean, there is no negotiations.

Senator LONG. Let me ask you, Dr. Cooper, are you familiar with what our intent was when we passed the Staggers Act, particularly with the amendment that I offered, to try to do something about this captive customer situation?

Mr. COOPER. The Consumer Federation and I personally worked on that legislation. We had, we believed that it was intended to provide a balance. Obviously, the ICC has read and interpreted it differently. We believe that what we are proposing in the Consumer Rail Equity Act, which—I recognize that Congress does not like to legislate details for a regulatory agency, but here are a few details that we are proposing that are completely consistent with the regulatory approaches of other agencies which we think will force the ICC, even an unwilling ICC, to implement what we thought was the intention of the act, particularly the captive shipper protection.

Senator LONG. If I had had my way, that particular language would have been easier to construe to your advantage. We had to compromise with Senator Cannon to get what we have. He is a consultant to the railroad industry right now, and I am not complaining about all that. He is a very fine man, and they have every right to employ any consultant they want to. But my point of view and his were not the same. It was a compromise. Unfortunately, the way that the Commission has construed the matter, I think, as far as I am concerned, has not been in line with what I had in mind.

For example, can you imagine anything as ridiculous as this stand-alone test? In order to get relief, you have to prove that you can build a railroad, run a railroad, and operate shipping nothing but your product on it. For example, if you are a coal shipper, you have to prove that you can build a railroad, haul the coal, and operate between the point from which you are shipping and the point to which you are delivering the coal if you are shipping nothing but the coal, and that you can do all this more cheaply than the railroad could—and the railroad has many other products that it can haul. Can you imagine anything more ridiculous than that?

Mr. **Cooper**. Let me turn it around and put it the other way. If you look at this particular rate proceeding, here is a rate proceeding in which the costs of the service, the actual real cost of the service never enters. You can imagine why ratepayers do not feel that they are getting a fair shake when here is the proceeding to establish a reasonable rate and the actual cost of providing the service never enters, and so that is why we are proposing that at least one of the things, at least to get it into the room so that everybody can see it and say, well, here is what it costs to deliver the service, and there will be differences of opinion, as there are in every regulatory proceeding, about how much exactly it costs, but at least get an estimate of what it actually costs to provide the service into the hearing room so that people can look at it and say, well, here is what it costs, and here is what it is costing the other guy, so that you can have some sense of where your rates are in relationship to the real cost of providing the service.

Senator **Long**. Now, prior to the time we passed the Staggers Act were not the railroads entitled to make a fair return on their investment?

Mr. **Cooper**. I believe the railroads were, and those railroads that shipped coal, even in the 1970's, were not in dire financial straits, but some sections of the industry were, but if you have coal, and if you have had coal and bulk commodities, even in the 1970's, that dark period of railroad history, you were not doing all that badly.

Senator **Long**. The point I want to make is that at least back under the old law, those about whom we are speaking here, those captive customers, would have at least had a remedy. Now, it would seem to me that when we in effect took the remedy away from them with the Staggers Act, we should have given them something in return that would give them at least some hope. Instead, they get what Mr. Flanders describes, where you come in and say, this rate is ridiculous, or outrageously high, and by the time the Commission gets through, the rate is doubled. Did they double it, Mr. Flanders, or somewhere in line with that? How much was the percentage increase by the time they got through with you?

Mr. **Flanders**. Over about 7 years, it has been almost 300 percent, but you were referring to the stand-alone a while ago. I have preliminary figures, and they are not factual, that we could comply with the stand-alone and pay less than they are presently charging us right now under that preposterous theory.

Senator **Long**. And you cannot get the benefit of that?

Mr. **Flanders**. I have preliminary numbers that we have done, our consultants have, but on the stand-alone approach our rate would be less than it is right now.

Senator **Long**. And you, as I do, regard the stand-alone cost as being pretty ridiculous?

Mr. **Flanders**. Yes, sir, I do.

Senator **Long**. Do you agree with that, Mr. Bellum?

Mr. **Bellum**. Yes; I do. In most of the areas, as you well know, the coal industry, is served by single railroads. In the first place, it would be virtually impossible to build a parallel road in the hollows of eastern Kentucky. The cost would be prohibitive even if you could. And your rail rate would be extremely high, so the stand-alone basis for determining rate reasonableness is ridiculous.

Senator **Long**. Thank you.

Senator **Packwood**. Senator Rockefeller.

Senator **Rockefeller**. Mr. Chairman, with your permission I would like to enter a statement in the record.

Senator **Packwood**. Without objection.

[The statement follows:]

OPENING STATEMENT BY SENATOR ROCKEFELLER

Mr. Chairman, as we begin a second day of oversight hearings on the effect of the Staggers Rail Act, I just want to reiterate my intention to press vigorously for legislative hearings in the Commerce Committee. In my view, the ICC, while implementing the law very, very well from the perspective of the railroads, has been derelict when it comes to protecting captive shippers, especially this nation's hard-pressed coal shippers.

Mr. Chairman, I am particularly dismayed that the ICC witnesses on Friday would say that they have heeded the resolution prepared by the Chairman of the Committee, Mr. Danforth. While it may be true that the ICC has "addressed" each item of abuse—revenue adequacy, market dominance, rate reasonableness and competitive access—they have done precious little to correct their outrageous interpretation of the law passed by Congress. In fact, I find that only in the area of the test on "market dominance" has the Commission done anything close to what the Danforth resolution prescribed.

Mr. Chairman, while there are those who would say, "lets give the ICC some more time," I think the time for waiting is over. Five years of abuse of the law is long enough, and far too long for the consumers and shippers of this nation to have waited. Certainly, this Committee should not stand still while monopoly profits are extracted from consumers of electric power and from a coal industry flat on its back and struggling to survive.

I urge we move ahead to debate and pass the Consumer Rail Equity Act.

Senator **Rockefeller**. Mr. Hertog, what is your bond rating at the present time?

Mr. **Hertog**. I cannot recall exactly what it is at this point in time. I can get that for you and supply it to the committee if you would like.

Senator **Rockefeller**. Do you have somebody back there that could get it for you quickly?

Mr. **Hertog**. No, sir.

Senator **Rockefeller**. All by yourself?

Mr. **Hertog**. No.

Senator **Rockefeller**. Is your bond rating a weak one?

Mr. **Hertog**. No, it is a strong one.

Senator **Rockefeller**. Do you have any idea about the level of dividend that your stock has paid in the last year or so?

Mr. **Hertog**. I think the dividend level at this point is $1.40.

Senator **Rockefeller**. And over the last 3 or 4 years it has been in that range?

Mr. **Hertog**. It has been less than that.

Senator **Rockefeller**. It is an average?

Mr. **Hertog**. Yes.

Senator **Rockefeller**. Do you know of any railroad in this country that is revenue adequate as deemed by the ICC?

Mr. **Hertog**. No, sir.

Senator **Rockefeller**. Why?

Mr. **Hertog**. Because the earnings level they have achieved is not such that it is equal to the current cost of capital.

Senator **Rockefeller**. When Conrail is being looked at by Norfolk Southern, where Norfolk Southern has purchased a van line, when a railroad has bought into an airline, when Chessie has purchased a barge line, when Norfolk Southern has reduced its debt from about $1.5 billion to $800 million in the last year or so, do those actions indicate that the railroads are on the verge of revenue adequacy?

Mr. **Hertog**. Those kinds of trends are certainly favorable from an economic standpoint. I do not know whether to characterize it as being on the verge of anything in particular, sir.

Senator **Rockefeller**. I understand. Do you have any idea how much short of revenue adequacy you are as judged by the ICC? Or what you have to do or be or get to be revenue adequate?

Mr. **Hertog**. I cannot express it except in these terms. I believe that our return on assets last year was about 10.2 percent.

Senator **Rockefeller**. You indicated that you had laid off how many workers?

Mr. **Hertog**. We had a work force of about 60,000 people that has been reduced to just slightly under 40,000.

Senator **Rockefeller**. Would you not agree, insofar as you know, that even by the end of 1983, utilities as opposed to railroads owned, as they had not before, some 33,000 more railroad cars, representing a tenfold increase in the past 10 years in that figure, and had made substantial investments in terminal facilities, loading facilities, and other facilities of this sort, costs which were at one time borne by the railroad, but which recently have been borne by the utilities, thus having an effect upon the costs to the railroad?

Mr. **Hertog**. I would have no quarrel with those numbers, Senator.

Senator **Rockefeller**. When the ICC was before us, they indicated that railroad rates had fairly much kept in touch with inflation. And they held up a chart, in fact, to so indicate.

Now, my point was that there has been, I believe, on the part of the railroads—you are using 12 percent fewer locomotives, approximately 11 percent fewer cars, and 31 percent fewer workers, all of which fit in with what you are saying.

Mr. **Hertog**. Yes.

Senator **Rockefeller**. Well, would it not be possible then that the actual costs to the railroad are really what is important here with respect to the rates that are allowed by the ICC? The rates are one thing, but then as they compare to the cost to the railroad, it seems to me that there could be a very substantially different line, that line being called profit, the difference between the cost to the railroad and the rate that the ICC allows to be charged?

Does that sound unreasonable?

Mr. **Hertog**. No; that goes exactly to the point I tried to make in my brief opening comments. The fact is that we have, in fact, improved our economic posture, but basically we have done that by reducing our costs.

Senator **Rockefeller**. Is that necessarily being reflected in the rates allowed by the ICC in view of the efficiencies and the reductions in cost to the railroad, which means less money paid out by the railroad, but maybe more money being paid by others?

Mr. **Hertog.** Well, as a matter of fact, since the maximum ratemaking authority of the Commission is cost-based, if costs go down, the maximum level of rates we can permit will also go down. And so I would view that as being beneficial not just to the railroads but beneficial to the public as a whole. I think that what has happened in the industry has served to keep rates lower than they otherwise would have been.

Senator **Rockefeller.** Well, Mr. Hertog, as you were talking, two gentlemen at the table were shaking their heads like this in wonderment. Why you think that people like myself from States like West Virginia which are entirely dependent upon rates that are charged on a shipment of coal, the coal companies and the National Coal Association, which I assume is not an ad hoc committee but an association of reasonable seriousness, Mr. Flanders, who I assume has come quite a long way, and Mr. Cooper, who has been here to testify many times, are making all this fuss? Why is it that Burlington, Norfolk Southern, Chessie and others of those big railroads say the Staggers Act is working well, and everybody else says it isn't.

Mr. **Hertog.** Because I think they come here with a sincere conviction that from their vantage point there are these disadvantages to them. I do not question their coming here at all.

Senator **Rockefeller.** One final question, Mr. Chairman, if I can indulge myself. Mr. Bellum, or Mr. Flanders, or Mr. Cooper, it is hard to judge these issues based upon region by region. If the ICC were enforcing market dominance and the other standards as the act was intended to be enforced, what would you suggest could be a range of rate reductions? How many dollars less per ton in some of the Appalachian regions or other areas might there be? Could we be talking $2, $3, $4, $5 a ton if the ICC were doing their job as we think it ought to be done? Any one of you?

Mr. **Bellum.** Well, I guess the only thing I can relate to is the kind of rate reductions that we have received where there has been competition between railroads, and we have in the coal industry seen rate reductions ranging from probably $3 or $4 a ton up to almost $10 a ton, where there has been competition between two railroads.

I guess that would lead me to believe that there is a potential of reducing rail rates in the areas where you have captive shippers and you do not have competition if that was monitored properly by the ICC.

Senator **Rockefeller.** Understandably, the ICC does not reduce rates. It ensures that they do not go up. So finally, Mr. Chairman, Mr. Hertog, your bond rating, sir, is double A.

Senator **Packwood.** Senator Kassebaum.

Senator **Kassebaum.** Mr. Chairman, I would be glad to yield my time to the coal interests. I am waiting for the grain panel.

Senator **Packwood.** That does not mean you get double time.

Mr. Hertog, you heard Mr. Flanders' story. Indeed, he knows what his rates are, and they have gone up alot. Why? I know it is not your railroad, but why have they gone up so much?

Mr. **Hertog.** As you point out, it is not my railroad. I would suspect that to some degree they have been able to work out an arrangement where the coal, instead of being shipped in single car lots, was perhaps shipped in trainload lots.

Senator PACKWOOD. Who is they?

Mr. HERTOG. They being the railroad and the shipper collectively. Under those circumstances, the transportation can be provided much more economically, and that in and of itself can justify a decrease in the rate. Certainly the factors of competition——

Senator PACKWOOD. But rates have gone up for Mr. Flanders.

Mr. HERTOG. I am sorry. I was talking about the gentleman who suggested that the rates had fallen by as much as $3 to $10 a ton.

Senator PACKWOOD. Maybe I am not following the answer. Mr. Flanders, your rates have gone up dramatically?

Mr. FLANDERS. Yes, Senator, that is true, and his feeble excuse for another rail carrier is a bunch of baloney. We own all of our cars. We load in unit trains. We got 2 whole hours to unload 100 100-ton cars. We provide the maintenance. We maintain the cars. All they do is provide their "power," the power being a locomotive.

Senator PACKWOOD. What I am trying to find out, Mr. Hertog, is whether or not Burlington Northern has a similar horror story on any of their coal shipments as far as you know.

Mr. HERTOG. We have five disputes that continue, one of which is in the court, and four of which are before the Commission, where there are questions in four of those cases with respect to the question of whether or not the rates being charged are reasonable. In each of those cases, we have negotiations in progress, and I fully expect that within the next 6 months they will all be solved.

Senator PACKWOOD. In your judgment, what could cause Mr. Flanders' rates to go up so much over a relatively short period of time?

Mr. HERTOG. I do not know the circumstances he is involved in beyond what I have heard today. It is difficult for me to comment on that.

Let me say this also, if I may, Mr. Chairman. When we currently have about 75 percent of our coal movements under contract, these are contracts that have been negotiated in arm's length bargaining with our customers. We have a considerable amount of the balance of our coal that is under negotiation. There is no doubt in my mind but that as time goes on, the vast majority of our coal is going to move under contract terms.

Senator PACKWOOD. Do the contracts have any escalation clauses?

Mr. HERTOG. Yes, they do.

Senator PACKWOOD. Based on what?

Mr. HERTOG. They are based on cost changes.

Senator PACKWOOD. Your cost changes?

Mr. HERTOG. They are based on cost changes for prices that affect the railroad industry, labor, material, fuel, things of that sort.

Senator PACKWOOD. Anything else?

Mr. HERTOG. No, I think those are the principal elements. They are called marketbasket kinds of escalators.

Senator PACKWOOD. There is sort of a consumer price index for the railroads in terms of what your costs are, only labor is thrown in as one of the costs.

Mr. **Hertog**. That is correct.

Senator **Packwood**. Senator Long.

Senator **Long**. When you speak about negotiating contracts, Mr. Hertog, here you have a captive customer sitting there, and he has either to use your railroad or to go out of business, and he knows from his lawyers advising him what his chances are if he goes to court—just like your lawyers are advising you that your gang has a 1,000-percent win record, he knows that his crowd has a 000 record because of the way that law is being construed at the Commission. What chance does he have to negotiate a good contract where he has quicksand under him, and you have a good, firm foundation, because your gang is winning in that court, before that Interstate Commerce Commission?

Mr. **Hertog**. First of all, Senator, they are not all captive customers. Some are not captive customers.

Senator **Long**. I am not talking about those. I am talking about the captive customer. What chance does he have to negotiate a good contract when you have him at your mercy and he knows that if he goes to court, his lawyers tell him, he is going to lose before the ICC?

Mr. **Hertog**. I think he has an excellent chance in at least two respects, Senator. One is that he may be captive today, but that is not necessarily what his situation is going to be tomorrow. He could well develop an opportunity for competition.

Second, he affords an opportunity to give the railroad a chance to participate in his business on a long-term basis, and thus better amortize the very substantial investments that a railroad must make in order to equip itself to handle this business over the long term. So those are at least two things that he should bring to the table. We look upon those as being very important.

Senator **Long**. Would you care to comment on that, Mr. Cooper?

Mr. **Cooper**. When you talk about that he will not be captive tomorrow, and that is the central difference between the people who are screaming hooray about the Staggers Act, and most of it is working well, and the captives, and particularly the electric utility consumer, we are talking about 30- and 50-year pieces of property. Coal-fired powerplants have proven to have tremendously long life spans, and you cannot pick them up and move them, and if you now start trying to run electric utilities by picking and choosing which plants to fire up on the basis of a coal rate out here, what you are doing is destroying the logic of that system. You are letting a little bottleneck monopoly, but it costs plenty, drive what is a very large fixed plant with a very long life.

So, sure, some people may go off line as a coal plant retires here and there, but by and large we have a backbone in this country of coal-fired electric utility plants that you can't move and you can't monkey with too much with economic dispatch, trying to fire this one up so you can force BN to negotiate a lower rate with you. It is a little hard to pull that kind of stuff. If you are Sears or others who have lots of stores and lots of plants, and you can threaten to move your business around, fine. But here you have got a very, very different problem.

And the difference is demonstrated in—he has got 75 percent of his business under contract. He has also had the one and only one case of an increase in competition. There is another railroad in the Powder River Basin, and that will get you a lot of contracts, and by God, those contracts are being signed 30 and 40 percent below the rates that were in place the day before. There is nothing like real head-to-head intramodal competition to discipline rates.

Senator **Long**. What is your reaction, Mr. Flanders?

Mr. **Flanders**. I thoroughly agree. You cannot pick up and move a powerplant. Additionally, if you are going to try to negotiate with someone who has all of the ammunition, they have as an example access to your fuel supply contract. You have entered into a contract, say, with a mining company. They know they have got you.

He says you can develop alternatives in southern Arizona? I do not know how the heck we are going to develop any kind of competition. The thing that is mysterious to me, you never know the cost. You never get it in the room. And I sometimes wonder if they are smart enough to know their costs. Rates are based on competition. They have no relationship to costs.

Senator **Long**. Thank you.

Senator **Packwood**. Senator Rockefeller.

Senator **Rockefeller**. Mr. Hertog, Senator Long and I are in total agreement on this and many other things. It occurs to me that his father at one point probably used to rail against something called rebating, which is something that my great grandfather used with great effectiveness, and which I think is applicable to your comments.

Back then, the shoe was on the other foot. In that case, he, with the Standard Oil Trust, might have said to the railroad, you either ship my product at 10, 20 percent less of a price or else I will give it to somebody else, and the power and market dominance of the trust at that point was such that he never failed to gain a rebate.

Now, there were those including Huey Long and many others who observed with care and fairness one said that that was quite unfair, and indeed by today's practices it was extremely unfair, but it was market dominance. They had no choice—the railroads, the railroads had no choice, and they always went along. Now, what is the difference, to follow on with Senator Long's point, if you have a single railroad coming into a single mine or a single source of operation and the railroad purports to be negotiating in good faith, but with the friendly ICC at its back, it can charge basically what it wants. What power does the coal mine, the shipper, have to negotiate, as in the case of the rebate—the power is there in theory, but in practice it is entirely absent, is it not?

Mr. **Hertog**. Well, I think that is where one of the differences lie as to whether or not the Commission in fact in implementing the market dominance provisions is doing so in a balanced fashion. We say it is. The opponents say they are not. But the points I tried to make before are——

Senator **Rockefeller**. Is not the theory of what I said a fair and accurate one in your own mind? Is the comparison not fair and accurate?

Mr. **Hertog**. I have no problem with the theory you have expressed. I think, though, that in many cases, perhaps not all cases, but in many cases, even though competition does not exist at origin or destination or both, we see in the territory we serve, at least, many things happening that are going to change that, and we keep that in mind, and we think that is an important tool for the shipper to use in his negotiations, and he uses it.

Second, there are other coals served by other carriers in other territories that are very competitive in many cases. Third, we see a lot of competition in the territory we served from power that is generated through hydroelectric sources in Canada. And that is a very significant competitive factor. There are all sorts of competitive things that we find, at least—perhaps we are looking at this wrong, but we find at least that shippers bring to the bargaining table when we negotiate a contract, and we take those into consideration.

Senator Rockefeller. Thank you, sir.

Mr. Cooper, do you support the reregulation of railroads?

Mr. Cooper. What we are talking about here is not reregulation. I have called it relegislation. We legislated the Long-Cannon amendments. We legislated captive shipper protections, and we did not get them, and so if you look at what has been proposed——

Senator Rockefeller. I am really looking for you to say no.

Mr. Cooper. We proposed a piece of legislation which is going to tell the ITC to do something.

Senator Rockefeller. But it is not going to be reregulation?

Mr. Cooper. It is not reregulation. We are not going to regulate any more rates. We have not lowered the jurisdictional threshold. I remember 6 or 7 years ago we talked about 160 and actually passed it in the House once in one vote, but we have not touched that jurisdictional threshold. No more rates are subject to regulation. How can that be reregulation? We have simply stipulated how you calculate revenue adequacy. We have said exclude deferred taxes from the rate base. Is that reregulation? No, that is simply saying, here is an accounting principle to apply. So, you go down the list of the seven or eight. We have shifted the burden of proof. It is the same regulation, but a different guy has to prove rates are reasonable instead of we have to prove them unreasonable. That is not reregulation. That is simply changing the playing field.

Senator Rockefeller. Understood. Exactly. Do you think that railroads should be allowed to engage in differential pricing?

Mr. Cooper. Absolutely. If you accept the jurisdictional threshold of 180 percent, you have accepted a very stiff dose of differential pricing, and there may be some very specialized railroads that do not even need a threshold that high, but 180 is a very stiff dose of——

Senator Rockefeller. Now, accepting your no and your yes on those two questions, there are those who say that anyone who supports the Consumer Rail Equity Act is in fact supporting reregulation of railroads and an end to differential pricing, and I would like you to say why you think that that piece of legislation does not in fact do that, but more importantly, gets at a specific, narrow area under the Staggers Act which needs to be pinned down.

Mr. Cooper. I have spent the last 8 months exchanging press releases and research reports with those people who say we want to regulate. If you accept 180 as the jurisdictional threshold, you have accepted differential pricing. We were not even placing a cap on differential pricing. The rates can go higher. What we want is a process that is fair.

So if you get 190 or 200, fine, but let it come from a process that shows the costs, the way the burdens have been allocated to others, and that there are not cross subsidies or inefficiencies, so that we are not against differential pricing. We think differential pricing, which is a very—a different kind of power that has been granted by this Congress, because differential pricing is not the dominant form of pricing. It tends to be associated with monopoly power. When Congress says you can differentially price, it should say, be very careful, and that is what we say. We want the ICC to ensure that railroads are very careful when we use this power of differential pricing.

Senator **Rockefeller**. Thank you, Mr. Chairman.

Senator **Packwood**. Senator Ford.

Senator **Ford**. I am almost afraid to ask Mr. Cooper a question.

Mr. **Cooper**. When you get 1 consumer and 30 or 40 industry people——

Senator **Ford**. I agree with you.

Mr. Chairman, I apologize for being late. I have read the testimony.

Mr. Hertog, is it cheaper to haul by rail or truck, on the average?

Mr. **Hertog**. For large volumes of coal, if that is what you are speaking of, sir, I would think that rail would be cheaper.

Senator **Ford**. Why then would those in Appalachia from Letcher County, Perry County, deep in the heart of Appalachia, ship their coal out of there by truck and then to Dayton and into Indianapolis?

Mr. **Hertog**. I do not know. I assume that overall it is more economic to do so, but I really do not know the answer.

Senator **Ford**. The answer is coal rates. I saw a big full-page ad in the paper here yesterday or the day before—maybe it was Friday—which said that 48 percent of all the tonnage hauled by that railroad was coal, 48 percent of all the tonnage. We have a problem, Senator Rockefeller and I. We do not have any problem about being revenue adequate, however. That was a good joke you made the other day. I just want to reemphasize that, Mr. Rockefeller.

My basic problem with the Staggers Act is, I think, borne out by the suits that have been filed and by the decisions by ICC. Those suits basically have been filed because the ICC did not comply with the Staggers Act. There were very few dissenters at the Commission—only one—and I believe one dissenter's seat is being eliminated. We will have four or five to nothing votes for railroads and against the shippers.

What we are trying to do, or at least what I am trying to do, is to leave everything alone where there is competition. I think that is what Mr. Cooper is trying to say. Where we do not have competition, somebody has to step in and help those smaller operators. Do you have any objection to that?

Mr. **Hertog**. No, sir, as long as, as I indicated earlier, we have a balanced approach here. We have no objection to that.

Senator FORD. We talk a lot about the Long-Cannon provisions, and one of those provisions, I thought, said that you do not use one product to make up for the loss from other products. However, when you begin to look at our part of the country, our product is making up a lot of losses, because, you know, the rates are deregulated for coal that is going to be exported. Lots of decisions have been handed down, and some have been turned around. But if the ICC had its way, those shippers would never have had an opportunity. So many small shippers do not have the accumulated wealth to take on a long, protracted case, lasting 3 to 5 years. So, I am not trying to put anybody out of business.

I would just like for some others to stay in business, and I would like for those who are trying to make it to have an opportunity for something that is fair and reasonable, particularly when you are a captive shipper, as in my part of the country—I am making more of a statement than a question. I see those operators with coal trucks hauling coal as far as Hazzard, KY, and to Dayton, OH. And one round trip a day is all that truck can make. That bothers me a great deal.

When we find an operator that buys the cars, has an old locomotive, goes down and picks up a unit train, takes it up to his tipple, fills it up, and takes it back to the train, then you have a subsidy for that railroad. They are not doing hardly anything. They are sitting down there and waiting for you. Then I watch one poor operator pay the cab fair for the engineers from Cincinnati to way down into Appalachia. That was one whale of a cab fare, but he had the train loaded, and needed to get it out, and the utility wanted the coal—these sorts of things I live with, and I do not particularly like to live with those things.

I have had shippers come into my office and talk about how great Staggers is, but when you begin to bring it down into their little sphere, they are in the top 15 or 20 of the Forbes list or Fortune 500—Forbes does not have about half what he had last week—and they have competition, and they are big. That is what Staggers' reworking is all about.

And I hope that we will be able to take action and some of these people will get the message that we are not trying to do anything to anybody. We just like to have the ability to let some folks live.

Thank you, Mr. Chairman.

Senator PACKWOOD. Other questions? If not, gentlemen, thank you very much.

Next let us go to a panel of Mr. Harding, Mr. Sexton, Mr. Oman, Mr. Burrill, and Mr. Bollard.

Gentlemen, as I said to the previous panel, your statements in their entirety will be in the record. If you would abbreviate your oral statements to 5 minutes so that we can ask questions, and as you can tell, we have ample questions to ask. We would appreciate that. And unless you have otherwise arranged, we will go in the order you are on the panel. We will start with Mr. Hardy. Let us wait about 30 seconds while those who are leaving clear out of the room.

[Pause.]

Senator PACKWOOD. OK, Mr. Harding, go right ahead.

STATEMENTS OF WILLIAM HARDING, CHAIRMAN OF THE TRANSPORTATION COMMITTEE, NATIONAL GRAIN & FEED ASSOCIATION; STAN SEXTON, EVANS GRAIN CO.; DONALD G. OMAN, VICE PRESIDENT-TRANSPORTATION, SCOULAR GRAIN CO.; MIKE BURRILL, PRESIDENT, EUGENE F. BURRILL LUMBER CO.; AND HOMER BOLLARD, GENERAL TRAFFIC MANAGER, LOUISIANA PACIFIC CORP.

Mr. Harding. Thank you, Mr. Chairman. My name is William Harding. I am vice president of transportation for the Louis Dreyfus Corp. of Stamford, CT.

As chairman of the transportation committee of the National Grain and Food Association, I am here today to enter this statement on behalf of the National.

National Grain and Feed is a voluntary association comprised of 1,250 companies and 44 affiliated State and regional grain and feed associations that include more than 10,000 grain and feed companies nationwide. The Staggers Rail Act has permitted carriers to adjust more quickly to marketplace developments, and has given railroads greater flexibility in marketing and ratemaking, but there are many accompanying effects of this legislation that pose a real threat to a competitive marketplace and warrant close scrutiny by Congress. The practical effect of the ICC rulemaking implementation of the legislation leaves considerable doubt whether the balancing of carrier and shipper needs intended by Congress is being achieved.

Our primary concerns are competitive access, private car access, and rail contracts. Concerning competitive access, we are seeing serious deteriations of intramodal competition that are intolerable in a free marketplace economy. Examples include the closing of joint rates and routes, cancellation of switching agreements, or setting of switching charges at exorbitant levels, and actions taken by rail carriers to discourage the use of and fair compensation for shipper rail cars.

A number of factors have contributed to the competitive access problem faced by grain shippers and their relationships to rail carriers, but the main contributing factor is a lack of enforcement of current law on the part of the ICC and the increasing monopoly power on the part of the railroads resulting from rail mergers.

Unlike the NIT League-AAR agreement on competitive access which calls for a complex and long litigative process in order to assume or assure a minimum amount of competition, we believe that competition, both intra and intermodal, should be a basic right of shippers, and where necessary, regulatory relief should be available and simple to pursue.

To encourage effective intramodal competition, we believe amending legislation may be necessary to define more precisely the intent of Congress. That law should ensure, one, that railroads join in joint rates and routes where such routes are cost efficient, and to ensure at least one competitive rate and route between all supply and demand points.

Two, that switching be guaranteed at all locations where possible and at a reasonable rate level. I might add that the NIT League-

AAR agreement does not seem to adequately address switching, if at all.

And three, that carriers seeking to provide competitive rail service be permitted the use of terminal facilities, including main line tracks for a reasonable distance beyond terminal areas. As railroads attempt to deny access to their lines by competitive carriers, they also attempt to deny entry to private hopper cars in an effort to monopolize carriage in their own equipment.

Throughout much of the 1970's, railroads' supply of covered hopper cars was chronically short, and both railroads and the ICC took steps to encourage shippers to supply their own cars. By 1982, 44 percent of the entire fleet of jumbo hopper cars were shipper owned or leased. By 1981, export markets for grain began to soften, and a car surplus developed. Railroads began to tell their grain shippers that they could no longer operate their private cars or place restrictions on the use of those cars, even though the grain industry had in many cases acquired those cars under very long-term leases, up to 20 years in many cases.

In 1981, a group called SCOT-5 petitioned the ICC to institute a proceeding the goal of which was to assure an equitable distribution of the economic burdens of a covered hopper car surplus. The ICC refused to entertain a request for any such rules. In the same year, SCOT-5 filed a formal complaint. An administrative law judge found last year that it would be unreasonable and unlawful for defendant railroads in the future to exclude entirely from their lines the privately owned hopper cars and directed the parties to negotiate a sharing formula.

The railroads filed appeals to the ALJ decision in October 1984, and after several unsuccessful attempts to bring the railroads to the negotiating table, SCOT-5 replied to the railroad appeal in April 1985. The decision on this matter was due out in October of this year, but the Commission appears to be sitting on it.

We bring these matters to your attention in the context of hearings focusing on the Staggers Act because we think that this issue represents another example of the Commission's unwillingness to encourage competition. Shippers need access to a viable source of competitive car supply.

Concerning rail contracts, National Grain and Feed and the AAR have successfully reached an agreement, which we are hopeful, if adopted by the ICC, will offer relief to many agriculture shippers on the disclosure of rail contract terms. We believe that agreement reached, if fully implemented and enforced by the ICC, would afford shippers the access to contract information and the protections originally intended by Congress in passing the Staggers Act.

The agreement provides for additional disclosure of nonconfidential information and contract summaries to allow shippers to better determine which contracts potentially affect them, and to prevent the vagueness and distortion presently so common in contract summaries.

The agreement also provides for two avenues in contract discovery under second tier. First, discovery would be granted in cases where shippers demonstrate that they would be affected by contract, and the carrier offers no objection. Second, the agreement established rules for submitting a discovery petition in cases where a carrier objects.

In our view, enforcement of current and previous rules on first tier disclosure have been lax, allowing carriers to deliberately distort summaries and to evade complainant action. We would urge Congress to monitor this situation to ensure that as with other rules, ICC enforcement is undertaken in such a way that congressional intent is being properly implemented.

Thank you.

[The statement follows:]

STATEMENT OF THE NATIONAL GRAIN AND FEED ASSOCIATION

My name is William C. Harding. I am Vice President of Transportation for the Louis Dreyfus Corporation of Stamford, Connecticut. As chairman of the Transportation Committee of the National Grain and Feed Association, I am here today to enter this statement on behalf of the Association.

The National Grain and Feed Association (NGFA) is a voluntary association of grain and feed firms ranging in size from the smallest country elevator to the largest grain and feed complex. Included in its membership are country and terminal elevators, merchandisers, processors and exporters covering the wide spectrum of the grain and feed industry. The Association's membership is comprised of 1,250 companies and 44 affiliated states and regional grain and feed associations that include more than 10,000 grain and feed companies nationwide.

Over the past decade, Congress has enacted legislation to help revitalize the nation's railroad industry by reducing the regulatory presence of the federal government in the rail industry. The most recent legislation, the Staggers Rail Act of 1980, gave rail carriers substantially greater operating freedom in virtually all areas of their business—service, competition and pricing. With nearly five years of experience with the implementation of the Staggers Act, shippers have experienced both beneficial and determintal impacts of this legislation.

Permitting carriers to adjust more quickly to marketplace development has generally led to improved rail service. Flexibility in rate structure has permitted rail rates to be more responsive to declining markets. But there are other accompanying effects of this legislation that pose a real threat to a competitive marketplace and warrant close scrutiny by Congress. In giving railroads greater freedom, Congress clearly intended to strike a balance between the needs of shippers and carriers. The practical effect of ICC rulemaking and implementation of the legislation leaves considerable doubt whether this balancing of needs is being achieved. Our primary concerns are with competitive access, private car use and compensation, and rail contracts.

COMPETITIVE ACCESS

Potentially the most onerous and anticompetitive actions by the nation's rail carriers are those relating to the closing of joint rates and routes; the discouragement of traffic interchange through the cancellation of switching agreements or the setting of switching charges at exorbitant levels; and actions taken by rail carriers to discourage the use of, and fair compensation, for shipper rail cars. Such deteriorations of intra-modal competition are intolerable in a free market economy.

The nature of both inter- and intra-modal competition in the rail transportation marketplace has changed dramatically over the past few years, as have relationships between rail carriers and shippers. Some of the changes have been decidedly favorable, while others have created severe economic hardship. But one fact has become increasingly clear. Namely, that competitive alternatives for rail shippers are becoming increasingly vulnerable to the actions and decisions of the rail industry in our present deregulated environment, and the opportunity for redress before the Interstate Commerce Commission continues to diminish.

The grain industry has been particularly hard-hit by the closure of joint rates and routes and the cancellation of increased cost of switching agreements. Numerous instances of inter-carrier disputes exist where the victim is the shipper who loses access to potentially profitable markets. The reason that this places such an economic burden on the grain industry is that we ship the majority of our commodities by rail and in most instances, grain elevator facilities find themselves dependent upon a single rail carrier for the transportation service.

In March 1983, the National Grain and Feed Association published a survey of grain transportation, which illustrates the severity of the problem for grain shippers. The results of that survey indicate that not only is the grain industry heavily dependent on the rail mode, but to a great degree, grain shippers are dependent upon a single carrier within the rail mode. In fact, of all country elevators in the sample that are served by rail, 94.3 percent are served by a single railroad. But, the problem does not end with country elevators. Our survey shows that terminal elevators also are dependent to a significant degree on a single railroad for their transportation needs. In fact, 63.5 percent of these facilities that are served by rail have direct access to only one rail carrier, but nearly half of these terminal elevators, that are served by one railroad, have the potential to take advantage of traffic interchange within their city's switching limits is switching agreements are maintained by the railroads. This demonstrates the importance of access to open switching to this segment of the grain industry.

NGFA's survey shows that all types and sizes of grain shippers, regardless of geographical location, can be affected by the anticompetitive actions of the railroad industry. But, even if the scope of the problem were not as wide, those shippers that are dependent on a single railroad would be no less harmed. Given this situation, one easily can see that the maintenance of competition among railroads is the only way that grain shippers can retain access to competitive markets and access to competitive rail service at a reasonable cost.

Critics might argue that grain shippers can gain access to markets and competitive transportation service by shipping via truck or barge. However, as a practical matter, this frequently is not possible. First, the majority of grain shippers are not located contiguous to a navigable waterway. Second, studies have shown that trucking grain to a barge loading point is economically feasible only when the elevator is just a short distance from the waterway. Third, truck shipments of grain generally are viable only for relatively short distance movements. Motor carriage is the most costly method by which grain moves, and it would take nearly 300 large trucks to do the job of a 75-car unit train in shipping grain for export or domestic use. This option simply does not make economic sense. Indeed, in a brief filed with the ICC on October 21 in the Santa Fe-Southern Pacific merger case, the United States Department of Justice stated: "The economics literature . . . shows that as to the movement of . . . large volumes of low-value commodities for long distances, truck is not an economic substitute for rail."

A number of factors have contributed to the problems faced by grain shippers in their relationships with rail carriers, but the main contributing factor is the lack of enforcement of current law on the part of the ICC and the increasing monopoly power on the part of the railroad resulting from the level of concentration in the industry that has been caused by a series of railroad mergers that have reduced the number of competitors and the level of competition in the industry. This problem is exacerbated in cases where rail mergers have been parallel rather than end-to-end.

In an effort to offer more adequate protection for shippers, the Association of American Railroads and National Industrial Transportation League entered an agreement earlier this year addressing certain aspects of the problems with joint rate and route cancellations, reciprocal switching and terminal access. While our association viewed this agreement as making some progress toward more reasonable interpretation of the statute, we were alarmed by the inconsistency of ICC approving the NIT League-AAR agreement and the ICC decision in the case involving Midtec Paper Corporation and the Chicago and Northwestern Railroad. In this case, the ICC ruled against granting requests for reciprocal switching and the use of terminal facilities, and in doing so, set a precedent for requiring that complainants demonstrate market dominance and rate unreasonableness as a prerequisite to relief. In another post-Staggers Act decision involving a grain elevator at Camilla, Georgia, the Commission concluded that expensive cross-town trucking obviated the need for reciprocal switching and adopted reasoning which strongly suggests that the Commission will view the "public interest" criterion of the reciprocal switching section as meaning a demonstrated need for reciprocal switching by a group of shippers, rather than by a single shipper. These decisions raise serious questions regarding the Commission's continuing outlook toward intramodal competition, whether under the NIT League-AAR agreement or otherwise.

We believe that competition, both intra and intermodal, should be a basic right of shippers, and where necessary, regulatory relief should be available and relatively simple to pursue. Agricultural and other shippers have been frustrated in attempts to pursue regulatory relief before the ICC. To encourage effective intramodal competition, the National Grain and Feed Association believes that amending legislation may be necessary to define more precisely the intent of Congress. The law should ensure: 1) that railroads join in joint rates and routes where such routes are cost efficient and/or to insure that at least one competitive rate and route between all supply and demand points; 2) that reciprocal switching be guaranteed at all locations where possible and at a reasonable rate level; and 3) that carriers seeking to provide competitive rail service be permitted the use of terminal facilities, including mainline tracks for a reasonable distance beyond terminal areas, if the ICC finds such use can be accomplished without impairing the ability of the rail carrier owing, or entitled to use, the facilities to handle its own business.

These proposed amendments to legislation would not reverse the philosopy that less regulation will enable railroads to prosper in a free market economy. They simply would ensure that as railroads exercise more service and pricing freedom, shippers will be provided with competitive rail service and a minimal degree of protection against unreasonable discrimination or destructive competitive practice.

PRIVATE CAR ACCESS

Another related area of anticompetitive behavior by railroads concerns the issue of private care use and compensation. As railroads attempt to deny access to their lines by competitive carriers, they also attempt to deny entry to private hopper cars in an effort to monopolize carriage in their own equipment, even though virtually all carriers encouraged grain shippers to acquire such cars when shortages existed throughout the 1970s.

The covered hopper car is virtually the exclusive railroad vehicle for moving grain and several other types of dry-bulk commodities. Throughout the 1970s and into the beginning of this decade, the railroads' supply of those cars was chronically and severely short; the shortage at times reached 30,000 cars daily. As a result, both the railroads and the Interstate Commerce Commission took steps to encourage shippers —especially grain shippers—to supply their own covered hopper cars.[1] As a consequence of these conditions, by 1982 shippers were operating nearly 76,000 grain-type covered hopper cars, or 44 percent of the entire fleet consisting of that type of car. For the first time in the history of the railroad industry, there was genuine competition in the supply of jumbo covered hopper cars, and it worked well.

By 1981, however, grain exports, which are responsible for a significant share of the railroad's grain traffic, had begun to recede and a surplus of grain-type covered hopper cars emerged. Many railroads apparently then decided that it was not such a good idea for them to allow covered hopper cars to continue to be supplied by competitive sources, and railroads began to tell grain shippers that they no longer could operate private cars or placed various restrictions on the use of those cars—even though the grain industry had in many cases acquired those cars under very long-term leases.

In 1981, a group called SCOT-5, comprised of many grain shippers and several companies in the business of leasing covered hopper cars, petitioned the ICC to institute a proceeding looking toward the promulgation of rules that would result in an equitable distribution of the economic burdens of a covered hopper car surplus between carriers and shippers. The railroad industry, through the AAR, opposed the institution of any such proceeding, and the ICC, without letting the petitioning group introduce any evidence, issued an order refusing to entertain a request for any such rules.[2] The ICC's rationale was that the railroads could rely on their ancient common carrier prerogatives, under which they are said to have a duty to supply cars and, therefore, the corresponding right to be the exclusive supplier of cars, as a justification for limiting or excising the use of private cars.[3] In a more recent decision, Docket No. 38921, *Allied Corporation* v. *Union Pacific Railroad Company*, —— ICC 2nd —— (February 22, 1985; pending on appeal in the United States Court of Appeals for the Third Circuit), the Commission adhered to a similar view.

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[1] The advice which the ICC gave grain shippers in typified by the following excerpt from a speech given by an ICC official (then Director of the Commission's Bureau of Operations) in November 1978 before the Montana Grain Growers Association:

"First, I believe it behooves each of you to assess your capability to acquire and utilize your own private car fleet. If your company is large enough or if you can combine your operations through cooperatives or other similar associations to lease or buy your own freight cars, I believe that you might find it in your best interest to do so."

[2] ICC Docket No. 38692, *Shippers Committee—OT-5—Review of OT-5 Agreements* (December 1981; not printed).

[3] There is no reported decision to which the ICC has directed any railroad to acquire even a single car to serve its shippers, despite massive and prolonged car shortages through the 1950's, 1960's and 1970's.

In the spring of 1981, the SCOT-5 filed a formal complaint proceeding, Docket No. 39169, *Shippers Committee, OT-5* v. *The Ann Arbor Railroad Company, et al.*, assailing the railroads' asserted right to veto the use of private covered hopper cars on several grounds. Among these were the contention that it would be inequitable for the Commission to turn its back on a private car fleet which the Commission, itself, had solicited into being; that it would be inequitable for the railroads, who had not merely failed to provide necessary equipment but had sought to induce shippers to supply their own cars through such devices as rates which were applicable only if shippers did, in fact, provide cars; and that it was anticompetitive, and discordant with the thrust of deregulation, for the railroads to assert the right to be the sole suppliers of covered hopper cars, just as the FCC and the courts had found that it was anticompetitive for the Bell System to assert the right to be the sole supplier of telephone equipment.

Voluminous evidence was introduced by both SCOT-5 and the railroads. In September 1984, an Administrative Law Judge found that, although railroads had an historic common carrier obligation to supply cars and thus a concomitant right to do so to the exclusion of cars supplied by others, different considerations should be applied for the future.[4] The Judge concluded that "it will be unreasonable and unlawful for defendant railroads in the future to exclude entirely from their lines the privately owned covered hopper cars of SCOT-5 members and other shippers and that continued access to those lines by such cars must be assured by an equitable sharing formula subject to reasonable terms and conditions." He then directed the parties to attempt to negotiate such a formula, failing which he stated that the Commission (presumably through a further order that he would issue initially) would resolve the problem itself.

The railroads filed appeals to the ALJ decision in October 1984. After several unsuccessful attempts to bring the railroads to the negotiating table, SCOT-5 replied to the railroads' appeals on April 23, 1985.

We bring these matters to your attention in the context of hearings focusing on the Staggers Act because we think that this issue represents another example of the Commission's apparant unwillingness to encourage competition—which the grain industry regarded at the time the Staggers Act was passed, and continues to regard as, the essential quid pro quo for deregulation—in the provision of railroad services. In an era when the ICC has chosen in so many instances to interpret the Staggers Act as a warrent to set aside so many concepts stemming from traditional regulatory approaches, it is not reasonable that the Commission advances hollow "common carrier duties" of yesteryear as its sole reason for endorsing a railroad effort to control and possibly monopolize the supply of freight cars. I call this so-called common carrier duty a "hollow" one because there has not been even one instance in the Commission's history when it has directed any railroad to acquire even a single car to serve its shippers, despite massive and prolonged car shortages in the past.

The ability to obtain and use freight cars supplied from sources competitive to the railroads is important to the grain industry for several reasons. First, the industry has an investment to protect in cars that were acquired as a result of railroad car supply deficiencies, railroad urgings and ICC urgings. Second, we need access to a viable source of competitive car supply to avoid a repetition of those horrendous days when grain rotted on the ground and farmers lost markets due to lack of railroad capacity and when railroads simultaneously assessed premiums for furnishing their own cars which were in short supply. All of us are hopeful that the current doldrums in which we find grain exports will not be permanent. When demand increases, as it must inevitably, it would be an unwarranted abuse of Staggers Act freedoms for the railroads to be able to monopolize the supply of cars or to price their own equipment excessively when others are willing and able to competitively provide alternate capacity.

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[4] The Judge made the following findings:

". . . The evidence clearly establishes, however, that it is not and never had been the intention of defendant railroads, individually or collectively, to acquire and maintain covered hopper cars in adequate number to handle all of the grain and other traffic that may reasonably be expected to be tenered to them for movement. . . . The conclusion is inescapable that the existence of viable fleet of privately own cars will continue to be essential to supplement the carrier, in the future as in the past. Defendants have made it as plain an can be, on the other hand, that they intend to maximize use of their own cars, particularly during periods of car surplus. . . . If this occurs, it is necessary to consider whether the privately owned car fleet can survive, hanging by its fingernails as it were on the fringe of this transportation movement, whether without some concrete assurance of regular use the privately owned cars will be there when they are needed."

RAIL CONTRACTS

The final issue I would like to address is rail contracts. As the Association of American Railroads (AAR) has already testified, the National Grain and Feed Association and the AAR have successfully reached an agreement in principle, which we are hopeful, if adopted by the ICC, will offer relief to many agricultural shippers.

In passing the Staggers Act and provisions legalizing private contracts between shippers and rail carriers, Congress had the foresight to understand potential abuses. To protect shippers, the legislation provided that agricultural shippers could file complaints on the grounds that a carrier had unreasonably discriminated by refusing to enter into a contract with the shipper for rates and services under similar conditions or that the contract constituted a destructive competitive practice. Clearly, to be able to offer complaints on these grounds, shippers must be able to obtain some degree to information about contracts filed with the ICC. And supposedly, Congress provided for this in 10713(b) of the statute that directed the ICC to "publish special tariff rules for such contracts in order to assure that the essential terms of the contract are available to the general public in tariff format."

In practice, however, under ICC rulemaking, shippers have not had reasonable access to the "essential terms" of contracts that would permit filing of complaints that afford the protection that Congress intended.

Under its first governing contract disclosure, issued in 1982, the ICC required a shipper to first file a petition demonstrating a likelihood of succeeding on the merits of a subsequent complaint in order to obtain the contract information necessary to file that complaint. We viewed this rulemaking as totally unreasonable and sought judicial review. The United States Court of Appeals for the Second Circuit sustained the ICC's rulemaking as far as its two-tier approach to disclosure, with the first tier consisting of contract summaries available to only non-confidential contract data. But the court also set aside and remanded the rules back to the ICC, stating:

"Easier discovery is necessary if the statutory right to challenge contracts is to have a meaning. We remand to the Commission to promulgate rules providing easier discovery for parties with standing to challenge contracts. Where a request for discovery is made by a party unable to determine on the basis of the (nonconfidential data) whether it is affected by a particular contract, the Commission can deny discovery only upon the finding that the contract in question does not affect that party. Discovery must be allowed where a contract affects a party with standing to challenge it."

In June 1984, the ICC issued interim rules purporting to comply with the Court's mandate. These rules remain in effect today. These new rules dropped the requirement that a party seeking "discovery" demonstrate a likelihood of succeeding on the merits of a complaint, but substituted in its place a whole new set of requirements for the complaining shipper that in fact have made the discovery process more difficult, especially for small shippers.

We believe that the agreement reached by the NGFA and AAR, if fully implemented and enforced by the ICC, would afford shippers the access to contract information and protections originally intended by Congress in passing the Staggers Act. The agreement provides more adequate disclosure of nonconfidential information in contract summaries and is very specific on the set of contract terms that will be disclosed at the first tier. This is intended to allow shippers to better determine which contracts potentially affect them and to prevent the vagueness and distortions presently so common in contract summaries. There have been instances this past year where complaining shippers have filed petitions and formal complaints, spending large sums of money in legal fees, only to find out that when discovery was granted, they were informed of a contract in which they had no interest. There are many other examples that could be offered, but clearly, the inadequacy of relevant information disclosure in contract summaries is posing a serious barrier to complaining shippers. The very specific language of the NGFA/AAR agreement is intended to leave no doubt as to which contract terms are to be included in the summary. But to be effective, these rules will have to be enforced. In our view, ICC enforcement of current and previous rules on first-tier disclosure has been lax, allowing carriers to deliberately distort summaries to evade complainant action. We would urge Congress to monitor this situation to ensure that, as with any other rules, ICC enforcement is undertaken in such a way that congressional intent is being properly implemented.

The NGFA/AAR agreement also would provide for two separate avenues to contract discovery (second-tier disclosure). First would be discovery which would be granted in cases where shippers demonstrate that they may be affected by a contract and the carrier offers no objection. Secondly, the agreement establishes rules for submitting a discovery petition in cases where a carrier objects. The agreement outlines specifically what is required of shippers in the discovery petition. As a part of this petition, the shippers must demonstrate "a willingness to accept similar terms and conditions for the purpose of filing a complaint" and/or "date showing that a contract would likely constitute a destructive competitive practice." This evidentiary showing shall be a prima facie showing and not a showing that must be deemed to be supported by a preponderance of the evidence. Finally, the agreement calls for the use of protective orders to ensure that contract terms are disclosed only to those parties seeking the information.

If implemented and enforced, this agreement would offer enough information in contract summaries to allow shippers to accurately assess which contracts affect their interest. On second-tier disclosure, the agreement would make the process of discovery less formal but would establish precise guidelines that would prevent unnecessary fishing expeditions into information on contracts that do not affect the complaining shipper. And the use of protective orders would ensure that the confidential aspects of contracts are released only to complaining parties that demonstrate they are affected.

We believe this agreement will, if enforced, implement the contract provisions of Staggers as intended by Congress, offering shippers a practical way to protect their interests.

Senator **Packwood**. Thank you.

Mr. Sexton.

Mr. **Sexton**. Thank you, Mr. Chairman.

My name is Stan Sexton. I am an attorney from Kansas, here today representing the interests of Evans Grain Co. and 10 other small agricultural shippers in the State of Kansas. Many of those shippers had the opportunity to testify before a field hearing of this subcommittee in Kansas in 1983, and one thing we heard was, you have not tried to use the remedies under the act to solve your contract rate complaints.

These 10 or 11 shippers whom I speak for here today have tried to obtain the remedy under the act by filing 3 complaint proceedings to obtain discovery of a particular contract that had been a source of economic injury and harm over a period of 4 years in Kansas. All three discovery proceedings ended without discovery of the contract that was responsible for the movement of that grain.

The detailed summary of our experience is set forth in appendix 1[1] of my written statement. Let us review in oversight what contracts were permitted to be used under Staggers. Section 208(a) of the act allows for rates to be set for specified services under specified rates and conditions in contracts, and I stress the word "specified rates" in the contract.

Outside of that, 208(a) of the act says no other contracting is permitted. Section 208(b) is the disclosure requirement, and it says that the Commission shall issue rules for such contracts in order to assure that the essential terms, and I stress the word "essential terms" of the contract are available to the public in general tariff format.

Well, rules have been established by the Commission. They have been up to the second circuit. They have been remanded. The Commission then issued interim rules. Comments were taken. And recently the National Grain and Feed and the American Association of Railroads have negotiated yet a third set or suggested set of rules.

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[1] The appendixes have been retained in the Committee files.

Included in the act were remedies for shippers for unjust discrimination or destructive competitive practices. Not much is said in the legislative history about that, but there is a floor comment by Senator Dole that if the rates got out of 2 to 5 cents per bushel differential between contract and tariff rates, it could have disastrous consequences on small shippers.

I was struck by the testimony here the other day, on Friday, about railroads and how the act has been good for them. A recent study has been published in Kansas by the USDA. Not much was said about it during Mr. Fitzpatrick's testimony. But that study shows that during that same period gross margins or profits for small agricultural shippers decreased 66 percent.

Their grain receipts, the grain that they are able to buy and merchandise, has decreased by two-thirds during the same period of time, that there has been a differential on the average of 11 to 13 cents per bushel in rates of contracts versus published tariffs, and that there have been documented instances that we have reported to this committee of rates being 36 cents to 24 cents cheaper on contract rates as opposed to tariff rates. But most importantly, it is the relationship between the rate that has changed.

In 1977, a noncontracting small shipper was able to pay within 1.54 cents per bushel for grain what a large competitor was able to offer the producer for that grain. In 1983, the difference went up to 45 cents a bushel, leaving little doubt as to where the producer is able to market the grain.

Let's talk about the specific problems, especially the problem of identity of essential terms of the contract. I spoke at a seminar back in Kansas for senior executives of milling and baking companies, and everybody was in agreement that an essential term of a contract was the identity of the parties to the contract. Perhaps the price is also an essential term. Neither of those two terms are made available in contract disclosure under present interim rules, and it is my understanding, while I have not seen it, nor would those two items be disclosed under the suggested rules negotiated between the AAR and the National Grain and Feed Association.

And just as importantly, the destinations, the points of origin, the transit points or any other shipper facility to which that contract applies will likewise not be disclosed.

Senator Kassebaum has noted that discrepancy and the absurdity of not including those essential terms in a disclosure because the shipper has an 18-day window after the contract is filed to file an objection. If he does not get it filed, it is over and done with for time eternal on that contract.

So I think we have got to really look at what are essential terms. These are the same kinds of problems the coal people are having in market dominance areas is what constitutes an essential term in our area.

As far as the disclosure of the rate, there is an analogy to the Shipping Company Act which would be applicable that says that the rate ought to be disclosed. More importantly, and I second what Mr. Harding said on behalf of the National is, is the Commission going to enforce the rules? And there are two things that need to be brought to mind here. This study in Kansas said 42 percent of the contracts were negotiated rate contracts. In the industry they are called variable rates. No rate is specified. Those contracts should never have been filed in the first place, but 42 percent of the west coast contracts are negotiated rate contracts. The Commission allowed them to be filed, they have evergreen clauses or automatic continuation clauses. So in essence, what carriers and shippers have been able to do is effectively deregulate grain for time eternal through the use of contracting.

I do not think that is what even the Commission had in mind when it issued its first rules.

Additionally, there were many discrepancies on enforcement that we note in our statement.

In closing, as I said on the outset, you have got 30,000 contracts being filed at the rate of 1,150 per month, and a shipper has to look at the contract summary, samples of which are set forth in appendix 3 of my statement, and make a decision on whether they are going to file an objection to the contract.

We did it on three occasions at an approximate cost over the three occasions of in excess of $25,000, and we never found the contract, and the only time we got close, the railroad and the carrier cancelled the contract and precluded discovery in that manner.

So I think oversight again is imperative on the concept and the issue of contract rate disclosure.

[The statement follows:]

STATEMENT OF EVANS GRAIN CO. AND OTHER KANSAS AGRICULTURAL SHIPPERS

My name is J. Stan Sexton. I am a partner in the law firm of Hampton, Royce, Engleman & Nelson of Salina, Kansas. I have been actively representing the interests of Kansas agricultural shippers and trade associations regarding rail transportation matters since the Staggers Rail Act was passed in 1980. I have represented such interests in prior oversight hearings and have recently concluded three discovery and complaint proceedings against rail transportation contracts in Kansas on behalf of Evans Grain Company of Salina, Kansas and ten other small agricultural shippers.[1] I am here today to enter this statement on behalf of Evans Grain Company and those shippers who have attempted to obtain the relief created by the Staggers Rail Act for small agricultural shippers.

The scope of my testimony will be limited to the nature and extent of disclosure of rail transportation contracts required under Section 208(b) of the Staggers Rail Act of 1980, 49 U.S.C. § 10713(b). I have been preceded on this panel by William C. Harding, Chairman of the Transportation Committee of the National Grain & Feed Association (NGFA), who has testified about NGFA's concerns with competitive access, private car use and compensation and rail contract issues. A majority of the shippers for whom I speak, including Evans Grain Company, are members of the NGFA and wholeheartedly support Mr. Harding's statements with respect to competitive access and private car use and compensation issues. In fact, the position of NGFA outlined in Mr. Harding's statement with respect to these issues has been given the unqualified support of the Kansas Grain & Feed Dealers Association, which represents the interests of some 1100 Kansas agricultural shippers.[2]

However, the interests of the Kansas agricultural shippers, for whom I speak here today, are not totally accommodated by the position taken by NGFA, both in its statement, and in the announced agreement with the American Association of Railroads (AAR), with respect to the nature and extent of required disclosure of essential terms of rail transportation contracts. The reason for our disagreement with NGFA's position on the rail contract disclosure issue is two-fold.

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[1] In addition to Evans Grain Company, this statement is submitted on behalf of Bennington Agri Services, Inc., Bertrand Elevators, Inc., Damar Grain Company, d/b/a Clifton Agri Services, Jewell Agri Services, Inc., Logan Grain Company, Morris-Greg-Mitchell Grain Company, Page City Grain Company, Quinter Grain Company, Winona Feed & Grain, Inc. and Mingo Co-op Grain Company. These grain companies in the aggregate were petitioners in three discovery and complaint proceedings described in Appendix I.*

* The attachments submitted have been retained in the committee files.

[2] See Comments filed by Kansas Grain & Feed Dealers Association before the Interstate Commerce Commission in Ex Parte No. 387, reproduced in Appendix III.

First, the Interstate Commerce Commission's (Commission) first and interim rules, and the rules suggested by NGFA and the AAR, are premised on the assumption that Congress did not mandate disclosure, in general tariff format, of the identity of the shipper that is party to a contract; the specific points of origin, destination, intermediate points, transit points or other shipper facilities affected by the contract; and/or the rate provided for in such contract. We submit that the same name of the contracting shipper, the actual origin, destination and transit points, and the actual rate are "essential terms" of the contract within the meaning of Section 208(b) of the Staggers Rail Act, which must be disclosed in first-tier discovery.

Secondly, the Commission has, through its failure to enforce its own current rules, permitted rail carriers and shippers to not only file non-confidential contract summaries that do not provide shippers with sufficient information to adequately determine the effect contracts have on them, but to use rail transportation contracts to substantially deregulate the shipment of grain and grain products. Given this history and economic harm caused thereby, many Kansas agricultural shippers of the opinion that Congress must provide specific guidelines to the Commission concerning not only the information that must be disclosed in general tariff format, but the legitimate uses that may be made in contracts.

Evans Grain Company, and the other small agricultural shippers that joined it in recent discovery proceedings against Kansas agricultural contracts, submits that the essential terms of rail contracts are not being made available ot the public in general tariff format, under any rules, final, interim or proposed, and that what rules have been adopted have not been enforced by the Commission.

BACKGROUND

Section 208(b) of the Staggers Rail Act of 1980, 49 U.S.C. § 10713(b) provides that: "Each contract entered into under this section shall be filed with the Commission, together with a summary of the contract containing such non-confidential information as the Commission prescribes. The Commission shall publish special tariff rules for such contracts in order to assure that the *essential terms of the contract* are available to the general public in general tariff format." (Emphasis Supplied).

In response to this Congressional mandate, the Commission established final railroad contract rules implementing this section on October 8, 1982. Ex Parte No. 387, rail Transportation Contracts, 367 I.C.C. 9 (1982).

These rules established a two-tier approach to discovery. At the first-tier, public disclosure of general descriptive material contained in the contract was required to be made in general tariff format. At the second-tier, more detailed information was to be provided to parties affected by a particular contract. The obvious purpose of first-tier discovery, which is accomplished by the filing of a non-confidential contract summary, is to put shippers who may be affected by the contract on notice that it has been filed. While these rules did not require that the shipper party to the contract be identified, the rules specifically required that first-tier disclosure include "identification of base rates or charges" contained in the contract itself. *See* 49 C.F.R. 1300.313(a)(6).

In *Water Transportation Association* v. *I.C.C.*, 722 F.2d 1025 (2nd Cir. 1983), the Second Circuit Court of Appeals found that the Commission had imposed too great a burden on shippers to obtain discovery of the actual contract in second-tier discovery through the requirement that such shippers satisfy a "substantial likelihood of success on the merits" test. The rules were remanded to the Commission to make discovery of these contracts easier.

On June 27, 1984, the Commission published interim disclosure rules which currently remain in effect. Neither these rules, nor those proposed by the NGFA and AAR require identification of the shipper that is party to the contract, all actual points in origin, destinaton, transit or shipper facilities affected by the contract, or of the actual freight rate specified in the contract.

WHAT ARE ESSENTIAL TERMS?

Evans Grain Company and other small agricultural shippers who have had experience attempting to obtain discovery of rail transportation contracts to avail themselves the remedy for agricultural shippers under the Act, submit that the identity of the shipper that is party to the contract, as well as the actual rate provided for in the contract, are essential terms within the meaning of Section 208(b) of Staggers, 49 U.S.C. § 10713(b), that should be disclosed in general tariff format. Additionally, the precise origins, destinations and transit points that are provided for in the contract should likewise be disclosed in the non-confidential summary, in order that shippers may determine if they are "affected" by the contract summarize.

Detailed summaries and case histories of Evans Grain Company and other shippers' experience in obtaining disclosure of a series of three agricultural contracts is set forth in Appendix I. The first major problem encountered by shippers in obtaining discovery and filing a complaint against a contract based upon information contained in a non-confidential summary was to determine whether the contract described in the non-confidential summary was in fact the contract that the shippers desired to complain against. Based upon experience, this task is a formidable one.

Rail carriers are routinely allowed by the Commission to describe origins and destinations using broad geographic descriptions. A series of three Santa Fe contract summaries are reproduced in Appendix II. Except for their reference to individual contract numbers, these contract summaries are identical. The identity problem is exacerbated by the variety of contracts that are encountered, such as origin contracts, receiver or destination contracts, transit contracts, "flat" contracts and the like. Without more detailed information concerning the exact locations to which the contract applies, be they points of origin, intermediate transit points or destination points, as well as the identity of the shipper that is party to the contract, a complaining shipper has what can be an insurmountable task in determining whether a contract may affect such shipper, on the basis of first-tier disclosure.

This problem was noted by Senator Kassebaum of this Subcommittee in comments filed with the Commission in Ex Parte 387. The Senator correctly noted the following:

"It is utterly absurd that there is no way in which to tell whether a contract that has been filed with the Commission is with an elevator down the road from you, or one 500 miles away. Through a tortuous corruption of the phrase 'essential terms' the Commission's rules state that the shipper in the contract need not be disclosed. By the time an elevator realizes it is receiving no grain and deduces that it is due to the fact that its competitor has a signed contract, it is often too late to challenge the contract. It is also often too late for the small shipper to ever recover. We can state categorically that it was not Congress' attempt to keep the other party to these contracts secret." (Senator Kassebaum, Joint Filing with Senator Dole, Comment at 3-4).

Neither the interim rules, nor those suggested by NGFA and AAR remedy this identification problem. While the suggested rules seem to require specific disclosure of points of origin and destination, the absence of a requirement that transit points or intermediate points be similarly identified is conspicuous. Additionally, the suggested rules do not require that the identity of the shipper that is party to the contract be disclosed.

In one discovery proceeding described in Appendix I, the Commission granted discovery of the contract at issue, but refused to require disclosure of the identity of the shipper—even at second-tier disclosure. Without having the shipper party to the contract identified, it is virtually impossible to provide market share evidence necessary to perfect a complaint that the contract in question constitutes a destructive competitive practice.

The experience of Evans Grain Company and others in obtaining discovery has not been with the Commission in determining that they have been "affected" by the contract against which they have complained. Rather the difficulty has been determining whether the contract described in the summary is the contract that affects them. Without providing the identity of the shipper and the precise points described in the contract, the identity problem will remain a formidable, if not insurmountable problem.

Moreover, the identity problem is further complicated by carrier and shipper practices that appear reasonably calculated to frustrate the very purpose for first-tier disclosure: to permit shippers to determine what contracts affect them. Examples of these practices are numerous, and include disguising origins (see Appendix I); the filing of identical (see Appendix III); using "dummy" points of origin and destinations; using "negotiated rate" contracts (see pp. 11-13 infra); and the like. These practices have reduced the entire contract disclosure issue to a practice akin to grown men planing the child's game of hide and seek or cat and mouse.

It seems all too obvious that the rate established by a contract, like the name of the shipper party and points to which the contract applies, is an essential term of the contract. However, Commission rules only require disclosure of the base rate or charge in the non-confidential contract summary. The actual freight rate remains confidential. As will be discussed later, the Commission has failed to enforce even this minimal requirement. The question of enforcement of existing regulations notwithstanding, the issue remains: Is the actual rate provided for in the contract an "essential term" thereof that should be disclosed in first-tier discovery. Evans Grain Company and other small agricultural shippers in Kansas submit that the answer is in the affirmative.

In March, 1984, Congress passed the Shipping Act of 1984, which specifically authorized the use of ocean transportation contracts, just as the Staggers Rail Act of 1980 authorized the use of rail transportation contracts. In this Act, Congress likewise required that the "essential terms" of the contract be made available to the general public in tariff format, and that those essential terms should be made available to all shippers similarly situated. Congress took care to include the actual transportation rate as one of the essential terms that was required to be disclosed in tariff format.

Either Congress means two different things when it uses the term "essential term" of a contract in a rail transportation contract and ocean transportation contract context, or the Commission has failed to determine that the actual rate is in fact a "essential term" of a rail transportation contract. We suggest that the latter is true, given the failure of the Commission to determine that the identity of the shipper is likewise an "essential term", as has been recognized by the minority floor leader of the bill in the Senate, Senator Kassebaum.

In September, 1984, the Kansas Grain & Feed Dealers Association submitted comments to the Commission in *Ex Parte* 387, just as Senator Kassebaum did. A copy of these comments are reproduced in Appendix III. Both sets of comments pointed out the failure of the Commission to provide for disclosure of essential terms; namely, the identity of the shipper that is party to the contract, and the actual rate provided for in the contract. The Commission has demonstrated no inclination to change the interim rules to include disclosure of these essential terms, and the rules suggested by NFGA and AAR do not provide for their disclosure. Congressional oversight is therefore necessary to clarify the intent of Congress on this issue and to specify whether such terms are essential and should thus be included in first-tier diclosure.

THE COMMISSION HAS FAILED TO ENFORCE ITS CURRENT RULES

Apart from the deficiencies in the interim contract disclosure rules issued by the Commission, is the Commission's enforcement, or failure to enforce, the rules that have been issued. The most notable and serious failure of the Commission to enforce current rules regarding the filing of rail transportation contracts has been made public in a recent United States Department of Agriculture, Office of Transportation study entitled "Impacts of Rail Deregulation on Marketing of Kansas Wheat", released on October 7, 1985. The report, which will be discussed later in this testimony, discloses that 40% of the West Coast contracts and 12% of the Mexican export contracts that were filed with the Commission between April 1980 and October 1983 that reflect Kansas origins, were "negotiated rate" contracts. No rate is actually specified in these contracts; rather the rate is to be determined at the time of shipment by the rail carrier and the shipper on a bid and acceptance basis. (Report at 15).

The first point to be made about "negotiated rate contracts" is that they are illegal and not authorized by the Staggers Rail Act. Section 208(a) of the Act, 49 U.S.C. § 10713(a) authorizes a rail carrier to ". . . enter into a contract with one or more purchasers of rail services to provide specified services under *specified rates* and conditions." (Emphasis supplied). No rate is specified in these types of contracts as required by statute, Nor do these contracts comply with current regulations issued by the Commission, which recognize the Congressional mandate that the rate must be specified in the contract and that a base rate or charge must be referred to in the non-confidential summary. See 49 C.F.R. § 1300.313(a). The statute and regulation notwithstanding, the Commission has permitted these contracts to be filed and approved. To make things worse, once these contract have been approved, the Commission no longer has jurisdiction over them and ostensibly, no shipper has any remedy under the Act to complain of these contract.[3]

We submit that not only are such contracts not authorized and illegal under Staggers Rail Act of 1980, by the Commission's own rules, such contracts must be amended, and a new non-confidential summary filed each time an economic term or condition of the contract is changed. In its original decision in Ex Parte No. 387, the Commission clearly stated that any change in the economic terms of a contract must be reported to the Commission by the filing of an amendment and a new non-confidential contract summary. The Commission stated:

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[3] See 49 U.S.C. § 10713(e), which provides that the Commission loses jurisdiction over contracts once they have been approved. Approval occurs automatically after 30 days if no proceeding is commenced by the Commission, either on its own motion or upon timely complaint by a shipper, to investigate the contract.

"Amendments to contracts will be subject to the same procedures and rules as the originally filed contracts. All amendments must be filed, along with a supplement to the contract summary. If the new term or terms have the potential to affect the lawfulness of the underlying contract, then review of the contract under 49 C.F.R. 1039.3(c) may be again available and the applicable remedies are revived. This filing requirement is in recognition that amendments are integral parts of a contract. And, for transportation services to be performed under a contract, the contract must be filed, Section 10713(b); only after Commission approval is effective will the transportation be exempt from Commission jurisdiction. An unfiled amendment would be invalid, and for any transportation performed purportedly under its terms would actually be governed by the existing contract (if applicable) or by applicable tariffs. Further, if amendments are not required to be filed, a contract could be rewritten without public knowledge through the use of amendments. This would conflict with the statutory protection afforded the general public to have essential contract terms disclosed." 367 I.C.C. at 11

The Commission clearly recognized one of the potential abuses of rail contracting: that carriers and shippers might attempt to "deregulate" shipment of commodities through the use of contracts. Evidence now clearly shows that such de facto deregulation has been affected by some carriers and shippers with tacit Commission approval. I am told that some shippers have been offered such contract provisions but have refused them when rail carrier law departments have refused to issue opinions of their legality. However, it is obvious that some shippers and carriers freely engage in this practice.

In some respects, such practices are a natural and expected result of the Commission's determination that rail transportation contracts may become effective on one day's notice, see 49 C.F.R. § 1039.2, notwithstanding the mandate of the statute that such contracts shall not be effective before the end of the 30 day period beginning on the date such contract is filed. 49 U.S.C. § 10713(e)(1). So long as the Commission permits contracts to become effective on one day's notice, which is well before any "affected" shipper can be put on notice of such contract, abuses such as the "negotiated rate" contract will exist, and in fact be encouraged.

Lesser failures of the Commission to enforce its own rules include routinely permitting contract summaries to be issued that do not accurately disclose the terms contained in the contract. In two of the three discovery proceedings in which Evans Grain Company was a petitioner, disccrepancies between the contract and the summary were noted. In one instance, the non-confidential summary failed to disclose a minimum volume requirement under the contract. When the appropriate Commission employee received inquiry from me, he contracted the rail carrier and required that a supplement be filed to the non-confidential summary to disclose such term.

In a second instance, the contract summary stated the base rate or charge under the contract was established by UP tariff No. 4013, the Union Pacific's Gulf export tariff. After the Commission ordered disclosure of the contract at the second-tier, it was discovered that the contract established a base rate not related in any way or manner to UP tariff No. 4013. Had this base rate or charge been identified in the non-confidential summary as required by Commission rules, 49 C.F.R. § 1300.313(a)(6), Evans Grain Company and the other petitioners would not have filed for discovery of the contract.

In light of the Commission's substantial failures to enforce even its own regulations, Congressional oversight is necessary to clearly and concisely set forth the time and manner that "essential terms" of the contract must be disclosed in general tariff format.

EFFECT OF RAIL CONTRACTING ON KANSAS SHIPPERS

The precise effect that rail transportation contracts would have on smaller agricultural shippers was unknown at the time the Staggers Rail Act of 1980 was passed. However, there was substantial concern that small agricultural shippers might be serverly disadvantaged, both in their inability to exercise bargaining power with railroads to negotiate contracts, and in their inability to compete with larger competitors should the latter's market power be enhanced by the new contract provisions.

In passing the Act, the Congress was clearly was clearly concerned that the use of contract could have an anti-competitive impact on smaller agricultural shippers. To address this concern, Congress included two provisions in the Act that permit agricultural shippers to complain against rail contracts that constitute either "unjust discrimination" or a "destructive competitive practice". Section 208(d)(2)(B)(i) and (ii); 49 U.S.C. § 10713(d)(2)(B)(i) and (ii).[4]

The legislative history of these sections clearly establish that they were included in the Act for the benefit and protection of small agricultural shippers. In the House-Senate Conference Report, the Conferees stated:

"It should be noted that these provisions were included in recognition of the fact that smaller shippers are particularly concerned about the market power of their larger competitors once the contract provisions are put into effect. It is the intention of the Conferees, that the Commission carefully review this aspect of the competitive situation in approving contracts." House Conference Rep. No. 96-1430, 96th Cong. 2d Sess. at 100, U.S. Code Cong. and Admin. News, 96th Cong. 2d Sess., 1980, at 7532-33.

In September, 1983 the Kansas Grain & Feed Dealers Association, through five of its member representatives, testified before this Subcommittee at field hearings conducted by Senator Kassebaum in Hutchinson, Kansas. At that time, there was testimony of the inability of smaller agricultural shippers to have sufficient bargaining power to negotiate contract rates with railroads that provided their exclusive rail service; testimony of economic harm suffered by smaller shippers in the form of lost grain margins and decreasing grain receipts occasioned by differences between tariff rates available to them and lower contract rates available only to larger competitors; and testimony of one known instance in which a contract rate was discounted by 49% from the tariff rate of $1.18 per cwt. to 58¢ per cwt. for a contract shipper. In this instance, the difference in rate was not cost justified on the basis of direct saving to the rail carrier attributable to efficiencies possessed by the contract shipper because both moves involved single car shipments from the same origin.[5]

While this testimony was apparently unpersuasive to the Subcommittee in 1983 to prove that the fears expressed by smaller shippers at time of passage were in fact being realized with three years experience under Staggers, the recently published USDA study now confirms much of the evidence presented at that time. In addition to finding that the use of "negotiated rate" contracts has substantially deregulated grain movements in Kansas export markets to the West Coast and Mexico, the report also contains the following findings and conclusions:

1. ". . . rail deregulation has resulted in economic injury for some shippers, particularly those in country locations attempting to compete with a competitor with a rail contract." (Report at iv).

2. "Shippers with origin contracts to the gulf paid an average of 17 cents per hundred weight less on grain transportation to non-contracting shippers using comparable tariff rates. Some non-contracting shippers are currently trucking grain to contract points because the contracting firms offer the best price. Margin for these sales are small to nonexistent." (Report at iii).

3. ". . . the ability to control volume from a number of different shipping facilities appears to be asset in contract formation . . . 84 percent of the contracts in the study sample were held by shippers with control over two or more shipping locations. . . ." (Report at 17).

4. "The average shipper with a contract for shipping wheat from Kansas has approximately 3 such contracts and an average of 18 shipping locations in an operating territory of 4 States and a total licensed storage capacity of approximately 40 million bushels." (Report at 17).

5. Contract shippers appear to have a permanent marketing advantage over tariff shippers in Kansas wheat marketing. The difference between the contract and tariff rates from Kansas points average 17 cents per hundred weight in country locations and 21 cents per hundred weight at terminal locations. "It is inconceivable that any firm could absorb a freight differential of 21 cents per hundred weight from these points and still remain in business." (Report at 19).[6]

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[4] The three discovery and complaint proceedings described in Appendix III were filed under both of these sections.

[5] See testimony of Gray Runnalls of Bertrand Elevator, Inc. and Sherman Baird of Garden City Co-op, Inc.

[6] The differences between contract and tariff rates set forth in the study are averages. USDA/OT personnel have refused to identify the highest difference noted in the study between a contract rate available only to the contracting shipper and the tariff rate available to all shippers. Prior testimony before this Committee indicated one documented difference of 60¢ per cwt. See text at 17. Assuming an even dispersal of differences above and below 17 and 21 cents per hundred weight for country and terminal points, respectively, differences of as much as 35 to 42 cents per hundred weight would be enountered at country and terminal points, respectively.

6. "Small single-location shippers generally do not participate directly in rail contracts and the competitive position of tariff shippers from country locations [is] threatened by competitors with a substantial market advantage from contract rates." (Report at 35).

7. "Impacts on small grain shippers are diverse. Local elevator shippers with rail contracts indicate they have benefitted as a result of those contracts through an ability to outbid competitors for grain. Some local shippers indicate no or slight loss of margin and probable reduced rate of growth in grain receipts, but no major adverse consequences of rail contracts and other non-uniform changes in railroad rates or services. In other cases, gross margins have dropped to one-third of previous margins or to no gross margins at all. Volume of wheat receipts has dropped to one-third the volume experienced before shipper had rail contracts with competitors were initiated." (Emphasis supplied, Report at 35).

8. The relative price of wheat among shipping points has been changed substantially by rail contracts. In 1977, the difference in the price of wheat at elevators located in Garden City, Kansas and Salina, Kansas was 1.54¢ per bushel. In 1983, the price at Salina at a facility that had a contract, was 45.08¢ per bushel above the price that could be offered by a non-contracting shipper at Garden City. (Report at 31).[7]

9. The report concludes that to the extent that reduction in price spreads at marketing points in Kansas are reflected in increased bid prices, farmers with access to these markets have benefitted from contract rail rates. However, the report states that at country points, where contract shippers compete with tariff shippers, "[i]t is conceivable that a firm with a marketing advantage from a rail contract could increase bid prices and still retain the bulk of the contract savings as an increased margin." (Report at 32). Thus, the nature and extent of short term advantage of rail contracting to producers remains open to question, as is the long term effect should competition at country points be eliminated by the winnowing process that is attributable to the significant marketing advantages noted.

These findings lead one to the inescapable conclusion that rail contracting has had a substantial impact upon the ability of many small single location country elevators to compete against larger competitors, especially competitors that have more than one location and, hence, greater economic bargaining power with rail carriers. Where a single country point is served by one railroad, such elevator's bargaining position with the rail carrier will not be equal to that of a competitor who has more than one location on several different railroads and can effectively use its competitive alternatives at some locations to obtain advantageous contract rates from the rail carrier that serves the captive location.

The remedies for agricultural shippers in the Staggers Act were placed there to protect against the very impacts that have been documented in the USDA Study. In Appendix IV, the excerpt of the April 1, 1980 floor debate on S. 1946, the Senate Version of the Staggers Act is reproduced.[8] The colloquy between Sen. Dole of Kansas and Sen. Cannon of Nevada demonstrates the concern that differences of as much as 2 to 5 cents in contract rates as compared to tariff rates ". . . could be dangerous to the survival of the smaller elevators. . . ." Differences of 17¢ per cwt., or 10.20¢ per bu. and 21¢ per cwt., or 12.6¢ per bu., are noted in the USDA Report as average differences existing between contract shippers and tariff shippers at country and terminal points, respectively. Testimony produced before the Subcommittee in 1983 documented a difference of 60¢ per cwt. or 36¢ per bu. Clearly, the anticipated rate disparities that gave rise to these remedies exist.

Another question not even addressed in the USDA Study is the disparity, if any, between contract rates granted to two shippers similarly situated. While in many respects, shipper attitudes regarding contract rate disclosure may be viewed from the opposing perspectives of "haves" versus "have-nots", there is evidence to suggest that substantial differences exist between contract rates available to competitors in the market place and that such differences are not justified on the basis of cost savings attributable to operating efficiencies possessed by one grain company and not by the other. In Appendix V, Richard Horn, manager of Mingo Co-op Grain Co., Inc., describes, by a verified statement, one instance of a substantial discrepancy of approximately 9¢ per cwt. between contract rates applicable to identical movements of wheat in 50 car units from the identical elevator to the identical destination. This evidence suggests that rate discrimination may be as much a problem between contract shippers as it is a problem between contract shippers and tariff shippers.

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[7] In September, 1983, this Subcommittee was provided with testimony that 8 to 10 million bushels of grain was diverted from Garden City to Salina because the price difference was so great the grain could be trucked at a cost of 25¢ per bushel and the grain marketed in Salina. See testimony of Sherman Baird, September 1, 1983.

[8] Attention is also invited to Sen. Cannon's understanding that contract rates would most certainly be higher than tariff rates in most instances, which understanding is conclusively disproven in the USDA Study. Also, this legislative history is relevant since the House Version of the Act contained no remedies for agricultural shippers, which remedies appear in Section 208(d)(2)(B) of the Act.

What remains an open question, at this point, is whether the effects on competition and the discrimination noted in the USDA study results from "unjust discrimination" or "destructive competitive practices", both of which are prohibited by the Act. It is most unusual for a remedy to have been created by statute some five years ago and yet be untested before the Commission or the courts. However this is the case with respect to the remedies created for small agricultural shippers.

We suggest that, to a large extent, this anomoly is directly attributable to the following. First, the Commission's contract disclosure regulations have made it extremely difficult, and on some documented occasions, impossible, to identify the contract that shippers desire to complain against on the basis of information contained in current non-confidential contract summaries made public in first-tier disclosure. Many opportunities to litigate allegations of "unjust discrimination" and "destructive competitive practices" are lost because of lack of information. With extensive use of automatic renewal or "evergreen" clauses, many existing contracts are thought to be free from Commission jurisdiction for time eternal.

Secondly, the Commission's enforcement of its current regulations has been so lax as to permit rail carriers and shippers to achieve de facto deregulation of grain and grain products in certain negotiated rate contracts. Even minimal disclosure requirements currently in effect are not being enforced. Thus, the economic damage some shippers presently suffer may well be consequences from "unjust discrimination" and "destructive competitive practices," which have not been litigated because of the lack of information necessary to seek discovery and perfect a complaint.

CONCLUSION

In summary, Evans Grain Company and the other small agricultural shippers who join in this statement, submit that the current rules issued by the Commission, as well as those now suggested by the National Grain & Feed Association and the American Association of Railroads, do not provide for first-tier disclosure of the "essential terms" of rail transportation contracts filed with the Commission under Section 208(b) of the Act, 49 U.S.C. § 10713(b). Essential terms of these contracts include (a) identification of the shipper that is party to the contract; (b) identification of the exact points of origin, destination, intermediate points, transit points or other shipper facilities to which the contract applies; and (c) the actual contract rate specified in the contract.

Additionally, given the Commission's record of enforcement of its current rules, which has permitted the filing and approval of negotiated rate contracts that substantially deregulate grain from regulation under the revised Interstate Commerce Act, more specific Congressional guidance and oversight is required ". . . to assure that the essential terms of the contract are available to the general public in tariff format . . ." as currently required under law. If necessary, Section 208(a) of the Act, 49 U.S.C. § 10713(a) should be amended to clarify that "negotiated rate" contracts are not authorized.

Finally, conclusive evidence is now available to the Congress, in the form of the recently released USDA Office of Transportation study entitled "Impacts of Rail Deregulation on Marketing of Kansas Wheat," to document significant disparities between contract rates available to relatively few shippers on one hand, and general tariff rates available to most shippers on the other. The report also documents the consequential economic harm caused by this disparity. Congress should again direct the Commission, as it did when the Act was passed, to study the disparity between contract and tariff rates to determine whether such disparities are justified on the basis of cost savings attributable to cost related efficiencies of operation of contracting shippers, or whether such disparities are in fact simply a form of rate discrimination.

Senator **PACKWOOD**. Mr. Oman.

Mr. **OMAN**. Mr. Chairman and members of the committee, my name is Don Oman. I am vice president of transportation for Scoular Grain Co., Omaha, NE. Scoular is a regional grain company serving over 30,000 farmer/producers in the western half of the United States. We market grain to exporters and domestic users.

The Staggers Rail Act of 1980 was the most significant piece of rail legislation since the act to regulate commerce in 1887. Prior to Staggers, railroads operated in a restricted environment of special rules regarding entry, exit, and control of rates and services. Rate adjustments prior to Staggers were slow to react to changes in supply and demand for movements of agricultural commodities. The Staggers Act provided a greater range of autonomous action for individual railroads. Competition has become the economic regulator of rates and services, replacing burdensome statutory and regulatory controls.

Let us focus on the competitive rail environment and its impact on the transportation of grain. Recent USDA studies on the effects of the Staggers Act on the grain marketing system indicate reduction of rate levels for export and domestic movements since 1980. These rate reductions reflect changes in supply/demand relationships in freight transportation markets and the ability of railroads to effectively compete in the changing marketplace. Grain exports have decreased since 1980, and domestic demand has remained relatively constant. Grain transportation capacity is currently greater than demand. An important aspect of this market condition is that the railroads have responded to the market. In the pre-Staggers pricing environment, I question whether the railroads would have been able to respond. The result would have made the American producer even less competitive in the world marketplace than he is today.

The competitive rail environment has encouraged and in many cases forced railroads to become more efficient. The rate reductions seen in the marketplace were made possible by improved efficiency. Modification and changes to the present regulatory environment would result, in my opinion, in a less competition or movements of grain.

I would like to address several issues raised by those seeking changes in the regulation of rail movements of grain.

Contract disclosure. The Staggers Act codified an ICC rulemaking decision in 1978 allowing shipper/carrier contracts. Provisions for the disclosure of nonconfidential information is required by the Act. The contract summary containing this information is made public at the time contracts are filed with the Interstate Commerce Commission.

The issue of disclosure is based upon the assumption that contract ratemaking is discriminatory. Rate structures, tariff or contract, have been historically discriminatory. Do railroads discriminate against "small" shippers? Yes. In most cases, shippers which tender single car shipments pay a higher freight rate than shippers which tender multiple car or unit train shipments. The statutory test of discrimination is: "Did the transportation occur under similar circumstances and conditions?" Single car shipments are not "similar" in circumstances and conditions to unit train shipments. Those shippers which have invested capital in facilities that can load unit trains should and must benefit from cost efficiencies of the unit train movements. Relative to the disclosure issue, the question has been raised, if the contracts are confidential, how can it be determined whether or not they are discriminatory. There are those who complain that due to the confidential nature of contracts and limited public disclosure, it is impossible to determine if a contract is discriminatory.

From a narrow legal prospective, I agree discovery is difficult. From the broader marketplace perspective, the infrastructure which has developed within the grain industry to discover contract rate information is effective and accurate. Through the use of contract summaries and grain market pricing, economic terms of contracts can be ascertained.

Our company has allocated our human resources to discover and develop rate information through the marketplace rather than to waste them in the legal arena. Any changes in the amount of information made public will have anticompetitive effects on rail rate structures, to the detriment of the public interest.

Cancellation of joint rates and routes. The grain industry has not experienced wholesale cancellation of joint rates and routes which existed prior to Staggers. However, new joint rate structures have developed slowly. The trend is changing. The lack of export demand which is normally served by a single line service has created a renewed interest in domestic markets. The geographic diversity of the domestic markets and the railroads serving surplus and deficit regions have forced carriers to establish joint rates and routes. The marketplace appears to be finding solutions to the problems of joint rates and routes.

The captive shipper. From our perspective, in most cases no captive shippers exist in today's grain transportation environment. Excess transportation capacity of all modes of transportation has created a competitive environment which provides numerous economic alternatives for the movement of grain from a specific origin. The only captivity that exists today are the limits on imagination and innovativeness that a shipper places upon himself.

In summary, it would appear that the grain marketplace has adjusted to the new rail regulatory environment. Significant benefits to farmers, grain shippers and consumers seem to be accruing from the changes in the regulation. The current regulatory environment is providing the necessary flexibility to effectively and efficiently deal with dynamic grain marketing and distribution systems.

Thank you.

Senator **Packwood**. Thank you.

Mr. Burrill.

Mr. **Burrill**. Mr. Packwood, members of the committee, I thank you for allowing us the opportunity to speak to you today. My name is Michael Burrill, and I am president of Eugene F. Burrill Lumber Co., located in Medford, OR. We are a closely held, small, family owned business. We have been in business about 40 years now. We specialize in the manufacture of quality 2 by 4 studs to be used in the framing of homes. We do not own any private timber. We exist entirely upon the timber supplied by the U.S. Forest Service and the Bureau of Land Management, and a little bit from some private timber companies.

Our reason for being here today is to talk a little bit about our concerns with the Staggers Act and now it is affecting the small- and medium-sized companies in the Northwest.

Due to the fact that I am the only witness representing the small- and medium-sized forest products companies, I would ask that it be noted that I represent the views of the vast majority of these small- and medium-sized companies of the Northwest. These companies sharing our concern include, but are not limited to, the approximate 200 company members comprising the Western Forest Industries Association, the North West Timber Association, Siskiyou Shippers Association, and the Inter-Mountain Wood Products Shippers Association. This includes members from California, Oregon, Washington, Idaho, and Montana.

I recently received a segment from the Federal Register that was printed back in the late 19th century. It had to do with the original Interstate Commerce Act, and it was a quote from a gentleman by the name of John Anderson, who was a Representative from Kansas. I wanted to read just a portion of that.

He talks about the problems that the shippers and the communities were having with railroads at that time and how that by unfair competition, the monopolistic powers of the railroads, that certain places, certain communities have withered and shrunk in their economic strength while others have grown in their local prosperity, all because of the contracts that in some cases were let and in other places denied.

It seems to me that many of those problems that we tried to do away with, that the people of that time tried to do away with, have come back and are haunting us today.

I want to state that we support deregulation, but there are some problems with it that we feel need to be corrected. Without going into all the details that I have in my written testimony, I want to state that it is our opinion that contracts should not be allowed in the transportation of lumber and wood products. The reason for that is that we move our lumber and plywood throughout this country to almost every community that you would find. It is not like when we are talking about moving coal or moving grain or something like that, or we are moving in a fixed direction on a fixed set of tracks, and because of the fact that we go everywhere, it does not work the same.

One of the problems that we have experienced as small shippers is that we cannot get the contracts that our larger competitors can get. We have been working on this, Senator Packwood, as you know, for some time now, and we have tried and we have tried and we have tried. The railroads have done their best to circumvent anything that we have done. We have formed associations to try to negotiate together as an association. As soon as the associations were formed, the railroads went to the individual members and tried to pick them off one at a time by offering contracts to them just to get them out of the association so that they no longer would be part of it.

They have lied to us, they have not been fair, and our problems are very severe.

One of the things that we have to look at is the fact that in the Northwest, those of us that thrive off of the timber supplied by the Federal Government, we have to buy that timber at a competitive auction. We bid for that timber. When a given company is given a contract that gives them a competitive edge in the selling of their product, that competitive edge then can be related back to the purchase of timber.

A competitive edge in our marketplace of $10 a thousand in shipments comes back and accounts to $15 to $20 a thousand in the price that a person can bid for timber. I was told last night that the U.S. Forest Service, through their planning process, is looking at reducing the sales program in region 5, which is California, basically, by as much as 60 percent over the next year or two. In region 6, which includes Oregon and Washington, they are looking at a 40- to 45-percent reduction.

You take that fact and then apply that against the competition that is necessary to buy timber, those of us without contracts in a short period of time are going to be out of business.

I believe that there was some conversation a little bit ago about the building of railroads if we had to, in order to move our own product. I would challenge you, I guess, that if you wanted to give us, our company or a group of companies like you did the railroads many years ago, every other section across this country, plus I think that is within 10 miles of the centerline, that maybe we could built a railroad. They were highly subsidized.

The next part I want to get to that I cannot miss, because I know my time is running out, is that I am appalled at the arrogance of two railroads, Southern Pacific and the Burlington Northern, the acts that they have taken in the last 3 months, and most specifically, the Burlington Northern within the last week.

About 3 months ago, the Southern Pacific Railroad drafted a special set of rates in conjunction with the Canadians for moving Canadian lumber into the California market. That contract, if you will, was done away with because we yelled so loudly. Everybody knows about the dialog that is going on, about the fact that the Canadians are shipping and selling nearly one-third of the lumber that is sold in the United States. Everybody knows that Congress is working very hard on protectionist legislation. Burlington Northern, late last week, announced a joint rate with the Canadian railroads to move lumber into California that will have an impact on my prices, where I exist, of about $20 a thousand.

Is that in the best interest of the consumer in this country?

Thank you.

[The statement follows:]

STATEMENT OF MICHAEL E. BURRILL, PRESIDENT, EUGENE F. BURRILL LUMBER COMPANY

My name is Michael Burrill and I am President of Eugene F. Burrill Lumber Co. located in Medford, Oregon. Our Company is a closely held family business that was founded by my father approximately 40 years ago. We are classified as a small business by the SBA and specialize in the manufacturing of quality 2x4 studs used in the framing of wood structures. We do not own any private timber and are totally dependent on our supply from the USFS, BLM and from a few companies who have their own private timber resources.

My reason for being here today is to share with you our concerns as to how the Staggers Act is affecting the small and medium sized businesses in the Forest Products Industry in the Northwest.

About two years ago, our company along with several other lumber and plywood producers in Southern Oregon became concerned about the inequities in rail rates and the contracts that were being written between the Southern Pacific Railroad and some large shippers of lumber and plywood. At the time we thought the problem was limited to those of us on the Siskiyou Line of the Southern Pacific Railroad. We formed a Co-op called the Siskiyou Shippers Association to try to negotiate contracts with Southern Pacific and thus bring equity into the market. Our efforts met with resistance every step of the way. If we were to measure our success it would be in destroying contracts of others and not in getting contracts for our members. As we met with other lumber and plywood shippers throughout Oregon, Washington, California, and Idaho, we found that the problem was wide spread and involves not only the Southern Pacific Railroad but also all the other railroads serving the Northwest.

Due to the fact that I am the only witness representing the small and medium sized Forest Products Companies, I would ask that it be noted that I represent the views of the vast majority of these small and medium sized shippers in the Northwest. Those companies sharing our concern include, but are not limited to, the approximate 150 company members which comprise the Western Forest Industries Association and the North West Timber Association.

Being a small business and a primary manufacturer in the Forest Products Industry presents a never ending challenge to survive. Most of the companies that I am representing here today have little or no privately own timber so we must depend on the USFS and the BLM as primary sources of our timber supply. That timber is sold through a process of competitive bidding under which it has become more and more difficult for the small and medium sized companies to compete. We also must compete in the manufacturing process to be efficient, to strive for the ever increasing level of productivity. The market for our lumber and plywood sales is worldwide and in the United States it includes all of the.50 states.

Our two areas of concern with the Staggers Act are as follows:

(1) Contract Disclosure.
(2) Competitive Access.

1. Contract Disclosure:

My company does not ship on flat cars, all rail shipments are carried by box car. The Staggers Act has completely deregulated box cars so there is no way to gain disclosure of a contract unless someone freely offers the information. Many other small companies use flat cars and the act does provide for disclosure of those contracts. The problem with the disclosure

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language as we see it is you have to hire someone in Washington to watch, on a daily basis, for contract information and then be prepared to respond immediately, with the correct procedures, regarding the filing of the contract. Even if we find that a contract has been written we must then file a complaint with the I.C.C. In that complaint we must identify the degree of damage that will be caused by the contract and prove why the contract should be investigated. According to I.C.C. docket information, the I.C.C. did not even begin its first investigation of a shippers complaint until February of 1985. Add to this fact that box car contracts are beyond the control of the I.C.C. and you can see the situation is impossible. Small companies do not have traffic departments and the costs and problems in gaining disclosure, in a timely manner, make it impossible for small businesses to react effectively.

It is our opinion that contracts should not be allowed in the transportation of lumber and plywood products. Contracts have their place in certain commodities but not in the shipment of lumber and plywood. If the basis for a contract is only volume, then we cannot as small businesses compete in the marketplace. If you take the economic edge granted to the larger companies because of the contract situation and apply it back to the purchase of timber, then we as small companies are also prohibited from buying the timber to run our plants. A freight advantage of $10.00 per thousand board feet of lumber is equal to $15.00 to $20.00 per thousand on logs. The granting of these contracts to large lumber and plywood companies, in affect, will destroy the small and medium sized companies chance to survive. We, the small and medium sized companies, will be the industry in the Northwest for at least the next decade. Most of the large companies are curtailing operations in the Northwest and are relocating to the South.

#2 Competitive Access:

The question of Competitive Access becomes very important to those of us that are captive shippers to the railroads. If we rely on the Staggers Act to handle this problem, we cannot win because no one is considered a captive shipper if they can use an alternate transportation system, no matter how unreasonable the cost factor may be. If we approach our business with an attitude that money will cure all our problems and not take into consideration economics or even the reasonableness of a proposed solution, then I suppose the Staggers Act and its approach to the competitive access question seems to do quite well. I find it difficult to believe that we are being forced into wasting time and money playing games. We are fighting to survive in this industry and we do not need the I.C.C. or the Railroads destroying us.

What we as small companies want and need is parity. We do not feel it is at all appropriate to grant special rights to others because of size or because they may live across town.

The railroads of this country were not built entirely by the railroad companies themselves. They were subsidized heavily by the government to generate a national transportation system. With the Staggers Act and Deregulation, the railroads have forgotten their customers and the real meaning of competition. They give special rates to a few and increase the rates to the rest of us to cover the losses from those contracts. The facts are that the railroads of this country are a monopoly and with each passing year they are strenghtening their monopolistic power at the expense of the American consumer.

All of us are aware of the controversy surrounding the ever increasing share of the U.S. Lumber Market being enjoyed by our neighbors to the north. The fact that nearly one-third of the lumber sold in the U.S. comes from Canada is well known. The fact that the Congress of the United States is and has been agonizing over protectionist legislation is also well known, so what do our railroads do but grant special contracts to the Canadians that allows them to undercut the U.S. market. It's true that those contracts no longer exist, because of the opposition we raised, but the damage created has not been corrected, it still exists.

As a representative of the Forest Products Industry in the Northwest, I would urge that further hearings be held in the Northwest where the problems are most severe. We need you to listen to and understand the problems that those of us are facing daily. If you rely entirely on the statements from the railroads, you will not be getting the whole picture. Let the railroads with their power base say what they want but the facts are that they, the railroads, are not meeting the intent of Congress when it passed the Staggers Act. The level of support generated for the Rail Equity Act and promoted by CURE (Consumers United For Rail Equity), should be an indication itself of the problem. We as an industry support the efforts of CURE but feel that they may not be going far enough with their efforts. We urge you to look closely at those who support the Staggers Act and you will find a list of large companies, with the ability to acquire these railroad contracts, and the railroads themselves. This list hardly represents the American Public.

In summary, I would state that we are strongly opposed to contracts in the transportation of lumber and plywood. We feel that changes are needed to allow a more competitive approach that will allow us access to a transportation system that will meet the needs of the shipper. The I.C.C. and it's interpretation of the Staggers Act will not and cannot solve our problems and the railroads, of course, will not solve it. Our only chance in solving the Staggers Act problems is for Congress to act and act quickly. Congress created the Staggers Act and only Congress can correct it. We also again request that further hearings be held in the Northwest to hear the views of our industry.

I recently received the following transcript from the Federal Register. The shippers in the late 19th century complained loudly and eventually the original Interstate Commerce Act was passed in 1887. A leading proponent of that Act, Representative John Anderson of Kansas, put it this way:

> "(Shippers) complain that by favoritism on the one hand and discrimination on the other, in the form of special rates, drawbacks, private contracts, &c., they are wronged; that thereby one mercantile house is enriched at the expense of the ruin of another; that one local shipper is bolstered up and his neighbor crushed out by the malice or the interest of the railroad company, and that the natural and fair competition of commerce and trade is destroyed by the artificial and partial preferences and discriminations of these great overriding public carriers. And, Mr. Speaker, these complaints have in too many cases been well founded. Grossest injustice has been done. Certain shippers have had undue preferences. Certain others have suffered loss by unjust discriminations. Certain places have withered in their local prosperity from unequal rates, and certain others have been favored and stimulated by special indulgences."

I wish to thank this committee for hearing our concerns and allowing us the opportunity to enter our testimony today.

Senator **Packwood**. Thank you.

Mr. Bollard.

Mr. **Bollard**. Thank you, Senator.

My name is Homer A. Bollard, and I am general traffic manager, Louisiana-Pacific Corp., headquartered in Portland, OR. LP is a major forest products manufacturer with 123 plants and mills in 21 States. Net sales through the first three quarters of 1985 were $948 million.

I speak to you as a proponent of the Staggers Rail Act as written and the Interstate Commerce Commission's interpretation of it. I was a proponent of rail deregulation at the time Staggers was in the process of markup. I supported it as the representative of Louisiana-Pacific and worked hard to gain its support in all trade associations I belong to, not without some concern of its consequences, I might add.

When you consider that we had 90 years of regulation, I believe the job that Congress and the Interstate Commerce Commission did with deregulation is remarkable. It had a great deal to do with returning our rail industry to a healthy financial and physical state. LP's rail traffic jumped from less than 25 percent pre-Staggers to approximately 45 percent today.

My company has had no serious problems with cancellation of joint rates and routes. Five years has taught us how to deal with contract rates, exempt quotes and single line tariffs. Joint bureau tariffs have become so burdensome and complicated that we prefer the new rating structures. It gives us the ability to be more creative in our dealings with railroad pricing people.

The demise of rate bureaus which made rates to protect the weakest, smallest, inefficient link is one of the reasons why rates have increased substantially less than the inflation rate. Boxcar deregulation has become a substantial marketing tool for our sales people. We have been able to make sales and penetrate markets simply because we have been able to make rates on the spur of the moment. In fact, I like boxcar deregulation so much I am totally in favor of deregulating flatcars.

As regards rail abandonments, Louisiana-Pacific has had its share of problems. We successfully fended off one abandonment, lost two, and have one pending. We were able to retain rail service in one case and possibly will in the second.

I see an indication that rail management involved in an abandonment is more than willing to make concessions to maintain service via short line operator or to ease the impact on industries affected by making rate concessions in alternative arrangements.

I firmly support rate contracts and the Interstate Commerce Commission's order on the confidentiality of forest products contracts. If the contracts were not confidential, I believe there would be little incentive to make them. Public contracts would have the effect of my negotiating for the corporation's competitors. Any rate contract I have consummated came only after hard, lengthy negotiations. Contracts have given both parties the ability to make capital expenditures, plan production, and control inventories because of the transportation stability they give our business.

My full statement goes into contracts in greater detail.

In conclusion, I feel that Staggers in its present form, is working well. I have noticed a decided improvement in the quality of railroad pricing and marketing personnel since its enactment. Many pre-Staggers railroad pricing people have blossomed since they have been able to operate in a businesslike manner. Those who did not are mostly gone. They generally know more now about our business and work with us to expand our markets. Generally, our service is better and our equipment supply is better. Admittedly, we have had to make changes in the way we do business, but in many cases, these very changes have been an improvement. There are still personalities in railroad pricing and marketing departments who are not taking full advantage of Staggers or who are making mistakes in their decisions, but I believe they are in the minority and that they are hurting their own companies more than the shipping public.

Perhaps Louisiana-Pacific Corp., because of its size, has some advantage over smaller firms, but I doubt it. Our facilities are scattered over a wide area, and no single complex could ship over 20 cars per day, nor do we have a location that could receive more than five cars per day, with the possible exception of a pulp mill in California that receives wood shiped by rail.

I believe that it falls upon myself and the people that work for me to keep Louisiana-Pacific Corp. competitive through transportation, and we have been able to do that by dealing directly with the carriers.

Thank you.

[The statement follows:]

STATEMENT OF HOMER A. BOLLARD, GENERAL TRAFFIC MANAGER LOUISIANA-PACIFIC CORP.

My name is Homer A. Bollard. I am General Traffic Manager of Louisiana-Pacific Corporation, headquartered in Portland, Oregon. L-P is a major forest products manufacturer with 123 plants and mills in 21 states. Net sales through the first three quarters of 1985 were $948 million. Attachment A lists our mill locations together with their annual rated capacities. I speak to you as a proponent of the Staggers Rail Act as written and the Interstate Commerce Commission's interpretation of it.

I was a strong proponent of rail deregulation during the time Staggers was in legislative process. I became very concerned about the condition our rail industry was falling into during the 1970's and felt the only way the trend could be reversed was through deregulation. Along with many of my colleagues, I had some fear that removal of the regulatory safety net could adversely affect my company, but the alternative of a rail system in disarray was the greater of two evils. The fact is I felt that deregulation could work, but lacked confidence in rail management.

The question today is, was Staggers the proper legislation, and is the Interstate Commerce Commission's interpretation of it working as was intended? From my personal experience, I say yes. The financial well-being of the carriers together with the physical plant itself, have improved dramatically and I am sure you have sufficient evidence of that. The shipping public as a whole is generally in a better position to be competitive insofar as transportation is concerned. I can say this without reservation through my own experiences and through conversations with other traffic managers, both inside and outside the forest products industry. In most cases, our rail rates are as low or only slightly higher than they were five years ago. Whereas less than 25 percent of our shipments moved rail just prior to Staggers, almost 45 percent do now. We are now using Trailer On Flat Car and Container On Flat Car where we did not before, giving us another mode of transportation. My company has had no serious problems with cancellation of joint rates and routes. Five years has taught us how to deal with contract rates, exempt quotes, and single line tariffs. Joint bureau tariffs have become so burdensome and complicated that we prefer the new rating structures—it gives us the ability to be more creative in our dealings with railroad pricing people. The demise of the rate bureaus which made rates to protect the weakest, smallest, inefficient link is one of the reasons why rates have increased substantially less than the inflation rate.

Boxcar deregulation has become a substantial marketing tool for our sales people. We have been able to make sales and penetrate markets simply because we have been able to make rates on the spur of the moment. In fact, I like boxcar deregulation so much I am totally in favor of deregulating flatcars. I feel it is too bad that the courts deemed it necessary to modify the initial ICC order.

As regards rail abandonments, Louisiana-Pacific has had its share of problems. We successfully fended off one abandonment, lost two and have one pending. We were able to retain rail service in one case and possibly will in the second. I see an indication that rail management involved in an abandonment is more than willing to make concessions either to maintain service via a short line operator or, to ease the impact on industries affected, make rate concessions and alternative arrangements.

The ICC's findings on market dominance has not caused us problems, perhaps because we have been able to work around adverse rate actions, either through negotiations or through alternative modes. In a letter I wrote in January of this year to the managements of Class I railroads (copy attached as Exhibit B), I cautioned them against being too prone to use market dominance as a defense in rate proceedings before the Commission. Whether they have taken my suggestion to heart, I cannot say. In any case, I believe a professional traffic manager should be able to handle most adverse rate actions directly with the carrier.

There seems to be a great deal of animosity and opposition to rail contracts. Some of this may be well-founded, but I believe much is due to misinformation and ignorance of the facts. I can state unequivocally that no contracts based on rates has been signed by Louisiana-Pacific Corporation without extensive and hard negotiations. If any of these contracts put our competition at a disadvantage, it is because our competitors decline to meet the terms of our contracts, are not as good negotiators or decline to attempt to make a contract. I am in favor of the I.C.C.'s order as it relates to confidentiality of contracts covering forest products. There would be little reason for ourselves or the carriers to make a contract if its terms were to be made public. Public contracts would result in my negotiating for L-P's competitors if they were willing and able to meet the same terms and conditions of my contract. Contracting gives both parties the stability to make capital expenditures, to make sales commitments, to control production schedules and inventories. A contract does not constitute an absolute disadvantage because a unique situation results in a rate which allows ourselves or one of our competitors to penetrate a market where the other has not been before. In fact, it may work to the advantage of the noncontracting firm as the contracting firm could transfer his sales efforts and available product away from a market in which the two have been competing. We have instances where a railroad has sent us a freight bill in error which gave us information about a rate on a competitor's contract. In every case where this has occurred, we have been able to contract at least the same rate. In almost every case our sales people call us to advise that another firm has a certain contract rate lower than ours, it has proven erroneous. Transportation contracting is relatively new to both industry and carriers. Mistakes and abuses have and will be made. Both parties are becoming more knowledgeable and sophisticated in contracting, however, and these mistakes and abuses are constantly being corrected.

I do not find surprising the fact that there are organizations and individuals working toward repeal or revision of Staggers. I personally know traffic managers of large corporations and individuals in small firms who are against deregulation. I believe they fit into one of three categories: (1) Those that want a regulatory body to do their work for them. (2) Those who for one reason or another do not retain a professional traffic manager or consultant and thus have not been able to benefit from deregulation. Many in this group do not even recognize that in many cases they have been benefitted. (3) Those who for some reason have a fear of what "might" transpire. I would hope that this Committee will give close scrutiny to allegations made by these people to ascertain whether or not they are valid.

In conclusion, I feel that Staggers in its present form is working well. I have noticed a decided improvement in the quality of railroad pricing and marketing personnel since its enactment. Many pre-Staggers railroad pricing people have blossomed since they have been able to operate in a businesslike manner. Those who did not are mostly gone. They generally know more now about our business and work with us to expand our markets. Generally, our service is better and our equipment supply is better. Admittedly, we have had to make changes in the way we do business, but in many cases those very changes have been an improvement. There are still personalities in railroad pricing and marketing departments who are not taking full advantage of Staggers or who are making mistakes in their decisions, but I believe they are in the minority and that they are hurting their own companies more than the shipping public. Perhaps Louisiana-Pacific Corporation, because of its size, has some advantage over smaller firms, but I doubt it. Our facilities are scattered over a wide area and no single complex could ship over 20 cars per day, not do we have a location that could receive more than five cars per day with a possible exception of a pulp mill in California that receives woodchips by rail. I believe that it falls upon myself and the people that work for me to keep Louisiana-Pacific Corporation competitive through transportation and we have been able to do that by dealing directly with the carriers.

The plight of the American forest products industry has been well publicized. Canadian imports have taken a large share of our market, but not because of actions taken by our domestic rail industry. The Jones Act is another matter. In fact, the railroads I deal with and that is most of them, have worked closely with us to help combat Canadian imports—in many instances quite successfully. I sincerely hope that the Congress does not tamper with a piece of legislation that has helped restore the rail industry to a healthy state, which thus has allowed it to help us prosper as much as possible against what many feel is unfair competition. I believe that what we now have is furthering our transportation policy and is in the public interest.

So that you understand the tone of this letter, I want to assure you that I am a complete supporter of rail deregulation. During that period when the legislation was being considered, I worked hard to gain support from the forest products and paper industries and from the legislature as a whole. The criticisms and suggestions which follow are given only in the interest of retaining that legislation.

I see a gaterhing of force in this country which would take us back to pre Staggers era. Believe me when I tell you that the nucleus of that force has been in existence since the time when rail deregulation was first considered. It is both powerful and vocal—you would be surprised if I gave you the names of some of the people in its makeup. Now the rail carriers are coming to the shipping public to gain support to combat the "regulators". The Committee Against Reopening Staggers (CARS) has been formed and I have joined that group. The railroad should know, however, that without substantial help form them CARS will not be successful. I firmly believe that more people are for reregulation than are against it. No one should be so politically naive as to think that personalities do not carry as much weight with legislators as sheer numbers.

At a workshop on deregulation at Golden Gate University in early 1981, I said "regardless of how we feel about the law, I firmly believe it is imperative that we do all possible to make it work. If the rail carriers abuse those provisions favoring them, it will make it politically impossible for the Congress to retain the law. Initially, operating within this law will result in many mistakes. It behooves us all to keep those mistakes at a minimum and make this law work, because the alternative is nationalization of our rail system, or at the very least, legislation which will provide for regulation which will make what we have had seem miniscule." Sure enough these errors were made, or at least the appearance has been given that they were made. So now we find ourselves in a battle which should not have begun in the first place.

The first error that was made, and this is a biggie, was the fight strong lobby effort by the railroads to have defined as narrowly as possible, market dominance. This action at the very least gave the impression that railroads were attempting to gain an unfair advantage over the shipping public and caused some people to meekly accept an unfavorable rate action—more converts to reregulation. If a railroad is unable to justify a rate action before the Commission, then in most cases it should not have been taken in the first place. The only thing I can see to be gained in circumventing scrutiny by the Commission, is at the expense of the proceedings or a delay in the effective date.

EXHIBIT A

Building Products

Sawmills

(Board feet 2 shifts 5 days *1 shift 5 days)

	Normal Capacities
Redwood/Whitewood (6 plants)	
Big Lagoon, California (A)	50 000 000
Carlotta, California (A)	60 000 000
Cloverdale, California (remanufacturing) (A)	—
Cloverdale, California (A)	65 000 000
Samoa, California (A)	100 000 000
Ukiah, California (A)	65 000 000
Other Western Lumber (25 plants)	
Burney, California (G)	45 000 000
Chico, Idaho (C)	75 000 000
Columbia Falls, Montana (C) (shut down indefinitely)	—
Covelo, California (A)	35 000 000*
Crescent Mills, California (G)	30 000 000*
Inyokern, California (G)	25 000 000*
Ketchikan, Alaska (D) (shut down indefinitely)	—
Kremmling, Colorado (C)	30 000 000*
Jamestown, California (G)	70 000 000
Lakeview, Oregon (G)	25 000 000*
Metlakatla, Alaska (D)	100 000 000
Oroville, California (G)	110 000 000
Pilot Rock, Oregon (C) (shut down indefinitely)	—
Post Falls, Idaho (C)	35 000 000
Potter Valley, California (A)	60 000 000
Priest River, Idaho (C)	55 000 000
Prineville, Oregon (C)	40 000 000
Red Bluff, California (G)	80 000 000
Rexburg, Idaho (C)	30 000 000
Sandpoint, Idaho (remanufacturing) (C)	—
Saratoga, Wyoming (C)	35 000 000*
Standard, California (G) (New mill startup 3rd Quarter 1985)	70 000 000
Truckee, California (G)	45 000 000
Walden, Colorado (C)	20 000 000*
Walla Walla, Washington (C)	30 000 000
Western Stud Mills (10 plants)	
Ashland, Wisconsin (F)	30 000 000*
Deer Lodge, Montana (C)	50 000 000
Dillard, Oregon (G)	30 000 000*
Dubois, Wyoming (C)	40 000 000*
Fort Bragg, California (also redwood) (A)	50 000 000
Moyie Springs, Idaho (C)	75 000 000
Riverton, Wyoming (remanufacturing) (C)	—
Tacoma, Washington (C)	45 000 000
Trout Creek, Montana (C)	45 000 000
Willits, California (also redwood) (A)	35 000 000*
Southern Lumber (25 plants)	
Alexandria, Louisiana (H)	50 000 000
Carthage, Texas (H)	55 000 000*

Medium Density Fiberboard Plants

(3/4 inch basis square feet 3 shifts 7 days)

Eufaula, Alabama (H)	70 000 000
Newberry, Michigan (F) (Scheduled startup mid-1985)	50 000 000
Oroville, California (G) (Scheduled startup 2nd Quarter 1985)	50 000 000
Total Medium Density Fiberboard (3 plants)	170 000 000

Particleboard Plants

(3/4 inch basis square feet 3 shifts 7 days)

Arcata, California (A)	100 000 000
Missoula, Montana (C)	100 000 000
Total Particleboard Capacity (2 plants)	200 000 000

Hardboard Plant

(1/8 inch basis square feet 3 shifts 7 days)

Oroville, California (G)	170 000 000

Other Building Products

Hardwood Veneer Plant

(Surface measure square feet 2 shifts 5 days)

Mellen, Wisconsin (F)	210 000 000

Millwork Plants

(Board feet 2 shifts 5 days)

Chico, California (G)(1 shift)	15 000 000
Red Bluff, California (2 plants) (G)	45 000 000
Total Millwork (3 plants)	60 000 000

Window and Door Plants (5 Plants)

Norton, Ohio (2 plants) (aluminum extrusions in lbs.) (I)	6 000 000
Orrville, Ohio (windows)(I)	100 000
Ottawa, Ohio (windows and doors) (I)	260 000
Winesburg, Ohio (windows and doors) (I)	170 000

Pulp, Paperboard and Containers

Pulp Mills

(Tons 3 shifts 7 days)

Ketchikan, Alaska (D)	175 000
Samoa, California (A)	210 000
Total Pulp Capacity (2 plants)	385 000

Paperboard Mill

(Tons 3 shifts 7 days)

Antioch, California (B)	250 000

Corrugated Container Plants

(Surface measure square feet 3 shifts 5 days)

Antioch, California (B)	800 000 000
Phoenix, Arizona (B)	430 000 000
Sacramento, California (no corrugator container plant only) (B)	—
Total Corrugated Container Capacity (3 plants)	1 230 000 000

Building Products

	Normal Capacities
Cleveland, Texas (H)	40 000 000*
Crestview, Florida (H)	75 000 000*
Eatonton, Georgia (H)	55 000 000*
Elizabethtown, North Carolina (H)	10 000 000*
Evergreen, Alabama (H)	40 000 000*
Grenada, Mississippi (H)	40 000 000*
Henderson, North Carolina (H)	40 000 000*
Jasper, Texas (H)	60 000 000*
Kountze, Texas (H)	10 000 000*
Lewiston, North Carolina (H)	50 000 000*
Lockhart, Alabama (H)	40 000 000*
Marianna, Florida (H)	40 000 000*
Nashville, North Carolina (H)	30 000 000*
New Waverly, Texas (2 plants) (H)	55 000 000*
Philadelphia, Mississippi (H)	50 000 000*
Pittsboro, North Carolina (H)	10 000 000*
Purvis, Mississippi (H)	10 000 000*
Trinity, Texas (H)	30 000 000*
Waynesboro, Georgia (H)	75 000 000
Westbay, Florida (H)	55 000 000
Winnfield, Louisiana (2 plants) (H)	50 000 000*
Northern Hardwood Lumber	
Mohawk, Michigan (F)	5 000 000*
Total Lumber Capacity (67 plants)	2 760 000 000

Panel Products Plants

Softwood Plywood Plants

(3/8 inch basis square feet 3 shifts 5 days)

Standard, California (G)	75 000 000
Logansport, Louisiana (H)	150 000 000
Lufkin, Texas (H)	140 000 000
New Waverly, Texas (H)	200 000 000
Urania, Louisiana (H)	200 000 000
Total Softwood Plywood Capacity (5 plants)	765 000 000

Hardwood Plywood Plant

(3/8 inch basis square feet 3 shifts 5 days)

Burney, California (G)	60 000 000

Waferwood Plants

(3/8 inch basis square feet 3 shifts 7 days *2 shifts 7 days)

Chilco, Idaho (C)	90 000 000
Corrigan, Texas (H)	140 000 000*
Dungannon, Virginia (F) (Scheduled startup 4th Quarter 1985)	90 000 000
Hayward, Wisconsin (2 plants) (F)	300 000 000
Houlton, Maine (F)	150 000 000
Kremmling, Colorado (C)	90 000 000
Montrose, Colorado (F)	90 000 000
Two Harbors, Minnesota (F) (Scheduled startup 1st Quarter 1985)	80 000 000
Urania, Louisiana (H) (Scheduled startup early-1985)	120 000 000
Total Waferwood Capacity (10 plants)	1 150 000 000

Insulation Products

Industrial Insulation Plants (4 Plants)

(3 shifts, 7 days)

Molded Insulation (cubic feet)	
Fruita, Colorado (E)	1 900 000
Ruston, Louisiana (E)	1 900 000
Total Molded Insulation (2 plants)	3 800 000
Panel Insulation (square feet)	
Fruita, Colorado (E)	9 000 000
Fiberglass Insulation (lbs.)	
Tucker, Texas (E)(Startup of 2nd line mid-1985)	15 000 000

Other Manufacturing Facilities (15 Plants)

Metal jacketing plant	Palestine, Texas
Printing plates plants	Emeryville, California; Los Angeles, California; Seattle, Washington
Insulated glass plant	Orrville, Ohio
Vinyl extrusion plant	Barberton, Ohio
Wood treating plants	Evergreen, Alabama; Grenada, Mississippi; Lockhart, Alabama; Marianna, Florida; New Waverly, Texas; Ukiah, California; Waynesboro, Georgia
Veneer slicing plants	Mellen, Wisconsin; Ridgway, Pennsylvania

Total Manufacturing Facilities (Plants) 123

Note: The capacities above are based on normal operating rates and normal production mixes. Market conditions, the availability of logs and the nature of current orders can cause actual production rates to vary considerably from normal rates.

Additional Facilities

Northstar-at-Tahoe

Summer and winter recreation and convention facilities and land development located near Truckee, California.

Distribution Centers (10 locations)

Camarillo, CA
Conroe, TX
Costa Mesa, CA (2)
Fremont, CA
Los Alamitos, CA
Oxnard, CA
Rocklin, CA
San Pedro, CA
Ventura, CA

Principal Export Docks and Products

*not owned by Louisiana Pacific

Ketchikan, Alaska: pulp, lumber; Lake Charles, Louisiana *: chips; Linnton, Oregon *: chips; Sacramento, California *: chips; Samoa, California: pulp, chips, lumber, particleboard; Seward, Alaska *: chips, lumber

Division Legend

A Coastal
B Container Products
C Intermountain
D Ketchikan
E Pabco Insulation
F Seaway
G Sierra
H Southern
I Weather-Seal

Railroads have accelerated abandonment of unwanted trackage since the passage of the act. Granted, one of the reasons for the act was to allow the carriers to trim costly property to improve their viability I firmly, believe that railroads, some of course more than others, have been over-zealous in using this new found freedom. I know for a fact that applications for abandonment have been filed on lines that were marginal. Best case figures are used, some of which are downright fraudulent. In most cases little or no thought is given to the businesses and communities being adversely affected by the loss or rail service. Little effort is being made to attempt to mitigate their problem. In some cases where there is a desire to purchase the line by those affected or a government agency, the price asked is far in excess of salvage value. It is not too difficult to get everyone in a community which has lost rail service to write their legislator.

Railroads were quick to cancel joint rates and routes and to cancel switching agreements. Any professional transportation manager recognized that many rates and routes should have been cancelled, but conversely, many that were should not have been. Past mergers have made this trend toward cancellation more onerous and give credence to the idea that large Class 1 carriers are abusing their monopolistic powers. The idea that single line route is always more economical is false, especially when that route is more circuitous than a joint line route. Route and rate cancellations have hurt many regional carriers and feeder lines which are badly needed in our national transportations system, and because thousands of businesses are served by these carriers, they have been hurt, too.

Boxcar deregulation, especially as it relates to car hire has recruited many to the regulation forces. The publicity given the bitter court case added more recruits. Not only were many small and short line carriers hurt, but car owner companies and their investors are suffering financial losses. Something had to be done to elimiante as much as possible the movement of empty boxcars, but the entire fault for those empty miles did not lie in car hire. Dictatorial, unilateral action by large railroads on car hire gives credence to the idea that they cannot act responsibly in a deregulated environment. Adverse actions against private cars gave the same impression.

The above actions by the rail industry are not the only actions which have recruited proponents to reregulation, but are those I consider to be most damaging. To counteract the idea that monopolistic powers available under the Staggers Act are being abused, I suggest the rail industry take the following actions as quickly as possible.

1. Let it be known that they will not contest the market dominance aspect in rate proceedings brought before the I.C.C.
2. Where abandonment of plant is necessary to the economic well-being, work as closely as possible with the affected shippers and receivers to maintain service either by maintaining the plant or by some means of providing alternate transportation that is affordable. Certainly reasonable and accurate numbers should be used in supporting statements. Where the line is marginal, maintain service at least for the present.
3. Make an immediate review of those joint rates and routes that were cancelled and where possible, restore them. Where a single line route is more economical, the rate structure will dictate its use, even if a joint route is available. Everything possible should be done to make shippers and receivers located on short lines and feeder lines as transportation competitive as their counterparts located on Class 1 carriers.
4. Make every effort to negotiate bilaterial car hire agreements on boxcars that give car owners and lessors a fair return on their investment. Grandfather the use of private cars at rate structures in effect on regular boxcars for the time of the lease in effect at the time boxcars were deregulated. Most of these leases have less than five years to run. Let it be known that renewed lease cars will not fall under the same rate structures and give the lessor accurate numbers to show why.
5. Stop making inane and inflammatory statements to the shipping public to justify a particular action or position taken. Most of them are preceived to be self/serving and false, and only tend to confirm to a proponent of regulation that a use of powers granted under deregulation have been abused. Generally these statements can be disproved and make great ammunition when talking to a legislator. Make sure that accurate numbers are available to justify an action and do not hesitate to provide them to interested parties.

Regardless of what is said, railroads are unique in the fact they control much of the nation's commerce and railroad management should recognize that fact. They cannot exist in a deregulated environment without self-restraint. Industry and government simply will not take at face value verbal assurances that abuses will not take place—history has proven them right. Railroads do not believe each other, why so should anyone else? Railroads must begin immediately through specific actions, to convince the public that they can operate in a deregulated environment without abusing their powers. They must be very careful to not give even the appearances of such abuses. I think it might be well for every railroad employee to read the history of those events which lead to the enactment of the original Interstate Commerce Act.

Unless the rail industry changes as I suggest, I do not feel that those of us in industry who favor deregulation are going to be able to convince the Congress to leave in place what we have today—we need the rail industry's help.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR LONG AND THE ANSWERS

Question 1. Mr. Bollard, you seem to be wearing two hats. Your prepared statement is a very impressive catalog of what is right about deregulation. We are extremely pleased that for you, the Staggers Act is working, as it is working for most shippers with competitive choices. On the other hand, though, the letter you wrote to the major railroads earlier this year which is attached to your prepared statement is also impressive—it's an impressive listing of the ways in which the Staggers Act has *not* worked. You list at the end of that letter five suggestions you made to the major railroads, on how they can alter their behavior and perhaps avoid the need for Congressional action. Would you please go through that list and tell us if the railroads have taken any of your suggestions to heart?

Answer. My letter to the Class I railroad executives was included with my testimony to show the Committee my support of Staggers and the Interstate Commerce Commission and to suggest ways in which railroad management could make it work without additional legislation. If that letter was read closely by the members of the Committee, it would be seen to be informative rather than critical and that it put forth the idea of *Voluntary* actions by railroad management—in other words, reasonable men reasoning together. I might add that I received generally favorable responses from a wide range of recipients from Stanley Crane of Conrail to Denny McNear of the Southern Pacific.

As to the five suggestions I made in my letter, the following is how I perceive rail management's reaction to them:

(1) I received no favorable response to my suggestion on market dominance. I have seen, however, a softening of rail management's hard line position as evidenced in the agreement in Exparte 456 wherein the burden of proof of market dominance shifts from the shipping public to the railroads. This is a very big change because it forces the railroads to investigate thoroughly the possibility of market dominance before they take a radical rate action. This is important because if they discover market dominance exists, they would stand a good chance of losing a case before the Interstate Commerce Commission and conversely if market dominance does not exist, they would lose business needlessly. As Welborn Alexander, Jr. of Seaboard Systems Railroad wrote me, "However, as market rather than regulatory forces increasingly control our dealings with shippers, rate cases are becoming infrequent. In short, I think you may see the issue die a natural death over time.". The impression offered by witnesses and members of the Committee that rail management sits in their conference rooms plotting to put the capitve shipper out of business is ludicrous. I know these people personally and they are nothing more than business executives bent on making their companies financially viable and they cannot do that by intentionally putting their customers out of business. Of course mistakes will be made, but I believe they will be corrected and no amount of legislation will keep them from being made.

(2) I have noticed a marked improvement in the railroad's handling of abandonments. I have two firsthand experiences to lead me to that conclusion. The Southern Pacific has had approved the abandonment of the branch line serving our Lakeview, Oregon sawmill. They have been working closley with the State of Oregon, the county, and the Lakeview shippers to arrange for continued service. The Chicago and North Western has delayed filing for abandonment of a line serving our Riverton, Wyoming sawmill even though the line has been losing money. They are working with the state, ourselves, and a competing railroad in an effort to retain service.

(3) The agreement worked out between the National Industrial Traffic League and the carriers and subsequently approved by the Interstate Commerce Commission in Exparte 445, indicates that the railroads are working to eliminate as much as possible, the problem of anticompetitive practices.

(4) I am informed by all the carriers who received my letter, that they are working on car hire agreements. As an example, Mr. W. P. Barrett of the Union Pacific Railroad informs me that they already have over 200 bilateral agreements in place.

(5) In my correspondance and conversations with railroad personnel, I detect a much more candid and forthright manner. This is certainly true of the comments I received in answer to my letter. In no case did I receive full agreement to what I proposed, but was given legitimate and candid reasons or any disagreement.

Question 2. Have you ever filed a rate complaint at the ICC? How do you think captive shippers fare today at the Commission?

Answer. I have in the past filed rate protests with the ICC, both successfully and unsuccessfully. I have not found it necessary to file a protest since the advent of Staggers, however, I see no reason why a captive shipper would not get a fair hearing before today's Commission, however, it is not made up of the same people as when I filed my protests and having no experience with the present Commission, I cannot say whether they are pro carrier or pro shipper. Since the Commissioners are confirmed by the Senate, it seems to me the Senate controls the attitude and philosophies of the Commission.

Question 3. Are you familiar with the Consumer Rail Equity Act, S.477? What, if anything, about it do you find objectionable? Please be specific.

Answer. I am familiar with the Consumer Rail Equity Act, S.477 and with its proposed revision. I am specifically against all three sections of the proposed revision. Section I would return us to the chaotic unproductive situation where all rate actions could be litigated before the ICC and would decimate Staggers. The ensuing delays to rate actions caused by passage of this section would return the railroads to financial instability. Section II of the bill is unnecessary in view of the findings in Exparte 445. The Midtec Paper Corporation v. Chicago and North Western case was begun prior to Staggers, so has nothing to do with Staggers. Section III would have the same result as Section I. The fact of the matter is, that S. 477 in whatever form, is plain and simple reregulation and its passage would return us to the same climate as pre-Staggers. To call this bill a clarification of the intent of Congress is a sham.

Question 4. In your prepared statement at page 3, you say that you oppose contract disclosure, because it "would result in my negotiating for L-P's competitors if they were willing and able to meet the same terms and conditions of my contract." Isn't that just what the Staggers Act intended for shippers of agricultural or forest products—that if a shipper could prove he was willing and able to enter into the same contract on substantially the same terms and conditions as you, it would be unjust discrimination if the railroad refused to do so?

Question 5. You describe Louisiana-Pacific as a "major forest product manufacturer with 123 plants and mills in 21 states, with net sales in the first three quarters of $948 million." Congress wanted the prohibition in the Staggers Act against unjust discrimination in agricultural or forest products to protect small shippers of these commodities who lacked market power. Why wouldn't a small forest products competitor of yours with just one or two plants be at a significant disadvantage in trying to negotiate a contract, when compared with your company and its 123 plants in 21 states?

Answers. I will answer questions 4 and 5 together because it seems to me they are asking for the same opinion, but in a different manner.

My view of what the Staggers Act intended was to relieve the rail transportation industry of archaic, suppressive, needless, and damaging regulation so that they could become viable enterprises. I supported the legislation because of the dire need to return our railroads to a profitable posture, and because I felt I could work within an unregulated atmosphere. My initial opinion has been borne out. Before Staggers, I considered the biggest threat to my industry and the country as a whole, the deterioration of our rail system to the point where a good share or all of it would fall to the same fate as the Penn Central. My company has gone to the expense of maintaining professional transportation people. We work hard to keep this company competitive with our competitors through transportation service and pricing. Neither our large or small competitors share in this company's expense. Mr. Michael E. Burrill stated before the Committee that he could not afford to hire someone like myself. My answer to Mr. Burrill is that he can not afford not to. Rest assured that Mr. Burrill hires the best lawyers, resource managers and millwrights he can find. There is available to Mr. Burrill any number of transportation consultants who would be happy to represent him at a lesser cost than myself. "Unjust discrimination" to my mind is a self-serving and unproven term. If, in the Senator's mind it means that Louisiana-Pacific Corporation's competitors should have the same contract negotiated by myself without the necessity of their negotiating for themselves, then I do not think they should have the same contract any more than a large corporation should have the same contract under the same circumstances.

Louisiana-Pacific Corporation's 123 plants are located from Maine to Florida to California to Alaska and served by many railroads. As I stated in my statement (pages 4 and 5), none of these facilities is a large complex which could command any special consideration. To suggest that the traffic from all Louisiana-Pacific's plants could be used to force or influence a special rate to the detriment of any of our competitors simply is not true. If a small forest products competitor could show its serving carrier that a contract would be economically beneficial to that carrier, I do not believe that he would be at any significant disadvantage.

The big disadvantage small shippers have is their lack of knowledge in transportation economics and their reluctance to obtain people who have that knowledge and expertise. In our industry, especially in the West, small business set-asides and timber taxbreaks have allowed the small firms to compete quite nicely with us. No amount of transportation equity is going to keep firms solvent who are mismanaged and underfinanced, especially when their largest competition is not each other but our neighbors to the North.

Senator **Packwood**. Thank you, sir.

Senator Kassebaum.

Senator **Kassebaum**. Thank you, Mr. Chairman.

Mr. Sexton, I would like to ask you what your thoughts are on the compromise that was reached regarding contract disclosure by the National Grain and Feed Association. Do you believe that it will address the interests of the smaller shippers?

Mr. **Sexton**. I have not read it, I have not seen it, so I just have heard from discussions with people at National, and Mr. Harding, what is in it. Specifically, they do not ask for the disclosure of the identity of the shipper, and I think that is something that you raised in your comments in ex parte 387, that it is absurd that you have to wade through all these contracts that are being filed and find the needle in the haystack if you want to object to a contract and you are concerned about one at one particular point by one shipper and one rail carrier. If it comes up and it is identified, you know that is the one you want to object to.

So I think the fact that they do not disclose the identity of the shipper is very, very significant.

Second, I understand that they want to have disclosure of the actual points of origin and destination but they do not want to disclose the intermediate transit points. For the smaller shipper there is no intermediate transit point applicable to any contract they would negotiate. That would only, I think, tend to operate in favor of larger companies who may not have the interest for disclosure.

So to that extent, the exclusion of transit points is significant and is necessary for smaller shippers.

So those two plus they do not touch the rate argument. I know there is a counterargument to including the rate in the contract summary. I can just recognize that as a theoretical argument, but not one that has got any practical value.

Senator **Kassebaum**. Well, Mr. Harding, let me ask you, because I really fail to understand why identifying the shipper violates the principle of confidentiality. I can see where rates and so forth certainly would. But it seems to me that grain shippers and perhaps forest products shippers—Mr. Bollard, you might have a comment on this, too—really need to know who the shipper that they are in competition with in order to make some judgment about what they should be concerned.

Mr. **Harding**. First of all, the agreement is a compromise within the Grain and Feed Association and between our association and the AAR, so not everything that everybody wanted is covered, and in many cases there are things in there that people did not want.

As far as the name of the shipper at a particular origin, our contract summary agreement would list the actual origins and the actual destinations. You can go into railway guides and look at those locations and see the facilities that are at those locations and which people own or operate those facilities. So I think to a certain degree that problem can be overcome by searching through the data that is available from the railroads themselves.

Senator **Kassebaum**. Well, but is that not an extremely time consuming and lengthy process, which many small shippers simply cannot afford?

Mr. **Harding**. I think it is more difficult for a small shipper than a large shipper, yes.

Senator **Kassebaum**. And that is really whose concerns we are addressing, is it not?

Mr. **Harding**. That is right.

Senator **Kassebaum**. I would guess, Mr. Bollard, in your comments, though, that you do not feel that identifying a shipper is necessary.

Mr. **Bollard**. No, Senator, I do not.

Senator **Kassebaum**. Do you think it really would be violating the confidentiality principle, however, to identify one?

Mr. **Bollard**. I really would not have a major problem of shippers being identified in contracts. The Commission has not seen fit to insist upon it, but personally, I do not have a problem with our being named as having signed a contract with a rail carrier.

Senator **Kassebaum**. I think based on the three cases that you cite, Mr. Sexton, that actually for some of the smaller shippers it becomes not only costly to challenge contracts, but in the end they are canceled if indeed too much pressure is applied.

Is this what you were implying?

Mr. **Sexton**. Obviously we do not know for sure who had the contract, and we do not know that that was the contract we were after. All we can say is we did a first proceeding, and for the Senators who may not have read it, we did a first proceeding which we are faced with the summaries that just say origin: Kansas, any point in Kansas or Colorado, and now we are trying to guess where the point of origin is, and we are looking for one particular location. We can file on that contract, and we get it, and they are 350 miles away, or something like that. I am under a protective order, so I cannot say. But it is not applicable.

Then we get one that we hear, as Mr. Oman said, in the trade you can understand from the rumor mill who has got what contract where, and we heard it was the contract we were after, and then all of a sudden it was canceled by the shipper and the railroad, and the Commission denied discovery, and then presumably that contract was then refiled, and we then had to find the needle in the haystack a second time.

So I think at a bare minimum you have got to have the identity of the shipper noted in there or you are not really sure which contract you are going to get because there may be five or six.

Senator **Kassebaum**. All of you have mentioned the lack of enforcement by the ICC and using the mechanism that exists under the law, but how do you respond to those who say that a small shipper is not utilizing, say, all of the service procedures that he could, or mechanisms that have been available under the law? I mean, do you feel that you, in representing Evans Grain, have utilized all of the mechanisms that have been available to you?

Mr. **Sexton**. I think we have utilized everything available. We get the contract summaries, we put them on computer, we try to keep track of them, we try to do what Mr. Oman says, but as you note in your study, or your statement in 387, if you do not file an objection within the first 18-days and the marketplace does not disclose the existence of the contract, and you cannot tell because the contract does not say who the shipper was in the contract within that 18-day period, you are done, you are over with, and the contract may, if it is one of these negotiated rate contracts, we mentioned in our statement that may be deregulated for time eternal, and I do not think that is what the committee intended, but that is exactly what USDA Office of Transportation found, was 42 percent of the contracts do not provide the rate, and they are never amended, and they go on for time eternal.

Mr. **Harding**. I think the answer to the question, in the past we have been caught in the embarrassing situation where we have called the Commission to ask about a contract summary because it was so general in nature, only to find out it covered the wrong contract, and we have not received the number yet from the carrier.

I truly believe that if those rules are followed, those shippers will be able to see who is affected, be able to determine within some limits who the contracting shipper is, and seek redress under the law.

Senator **Kassebaum**. Thank you.

Senator **Packwood**. Senator Long.

Senator **Long**. I do not understand the contract issue as well I would like to because I have not been involved in that particular kind of business, but I believe I can understand your problem because we have had parallel problems in other areas in my part of the world.

It is not unusual in Louisiana to have a contract where a person with a relatively small amount of gas decides that he does not have the bargaining power of someone with a large amount of gas, and so he signs a contract to sell gas on the condition that if they give a much better price to someone else, he gets the benefit of that price. I am familiar with people having to go to court because someone signs a contract much more favorable to someone else but succeeds in keeping that a secret for many years, and thus someone is paying a far better price to someone else than he was paying to a small seller who did not have the market power that the large seller had.

I cannot for the life of me understand how one could justify in the national interest keeping that information secret from one who is being adversely affected by it and being denied his rights.

Have you worked out a proposed amendment under which you could get the information that by right you are entitled to?

Mr. SEXTON. I think what we have suggested in appendix I was along the lines of the resolution language that Senator Danforth had introduced in S. 331 last year, to specify that when essential terms and conditions of the contract will include the following information, you did that in the Shipping Act of 1984. You used the term—it did for ocean transportation contracts what Staggers did for rail transportation contracts, but when you used the word "essential terms," you said those shall include, but not be limited to, and then you gave a laundry list of essential terms.

Maybe that kind of an approach is going to help, but in essence, a lot of that really begs the question because you are talking about a matter of market power. This study from Kansas finds that the average contracting shipper controls 18 origins of grain in 4 States and has 40 million bushel storage capacity, and he has 4.33 contracts with two different railroads.

Now, what that means is that in Senator Ford's situation not only are a lot of Kansas shippers in essence captive to a railroad, because they have only got one railroad serving them, and I appreciate Mr. Oman's comment. True, you can maybe truck it to some other place and sell it there and apply ingenuity, but the simple fact of the matter is if you go in and you are a single carrier or you are a single origin grain company, then you are on one railroad, and then that railroad turns around and negotiates with a shipper who is right down the line from you like he might with a coal company and gives him the contract and does not give it to you, I have got in appendix 5 of our statement a situation where you cannot argue that the cost differential is there, the guy made the same improvement, he could load 50 cars just like the next guy did, and his rate was 9 cents a hundredweight, or 5.4 cents a bushel more than what his competitor was, which took him out of the marketplace, and that is not justified.

And I think those kinds of things happen, but the reason they happen is because you start out with the whole concept of market dominance and market power, and the contracting has simply enhanced that power by adding to it another screw that can be turned.

Now, I do not know whether that constitutes unjust discrimination or destructive competitive practice, but we have never had an opportunity to litigate it because we have never gotten disclosure of a contract that we were after.

Senator LONG. Thank you very much.

Senator PACKWOOD. Senator Ford.

Senator FORD. Thank you, Mr. Chairman.

Mr. Sexton, you are beginning to talk my language. You made a statement earlier, in the early part of your statement, that at a particular time it was 1.54 cents or a certain percentage difference. What was that?

Mr. SEXTON. In 1977 the differential, the price differential between a small and a large, was 1.54 cents, cents per bushel.

Senator FORD. And in 1983 it was 45 cents per bushel?

Mr. SEXTON. Correct.

Senator FORD. Between the big shipper and the small shipper.

Mr. SEXTON. Correct.

Senator **Ford**. And that, for all practical purposes, puts that small shipper out of business. It puts him out of business because of the rate.

Mr. **Sexton**. That is correct.

Senator **Ford**. Now, Mr. Oman, I want you to tell me why some changes in the Staggers Act should not be made based on that situation. I am also thinking about the situation of hauling coal out of eastern Kentucky by truck rather than by rail when the railroad says that the haul should be cheaper by rail than by truck.

Now, you tell the small shippers to start hauling by truck. I do not want to hurt the truckers, but I sure do want to help the farmers. They are holding on by their fingernails.

Mr. **Oman**. An important point to make, is that we in the grain industry are a service to the farmers and that our economic welfare is based upon the economic welfare of the farmer, and it is the grain industry's position to get the best price for that farmer, and as the USDA study shows, from 1977-80, grain rates in Kansas, to the Gulf increased by 60 some percent. From 1980-84 the rates were reduced, and although it cannot be determined where that reduction went, the conclusion was that most of that reduction went back to the farmer.

It is not in the best interest for a railroad to pick and choose and discriminate between big and small shippers in the State of Kansas. Because of the transit provisions in most tariffs and contracts, the single car shipper in Kansas has benefitted from unit train structures. And who is benefitted by that? The farmer.

There are isolated situations where maybe there are one or two contracts that discriminate over a short period of time but that situation only exists for a short period.

I would challenge that person that has been discriminated against to do his homework and go to the carrier and get the job done.

Senator **Ford**. And if he does not know with whom the contract is and it is not disclosed, that is very difficult to do, and he should not have to be placed in that position in the first place. That small shipper ought to have the same opportunity, the same ability as the big shipper. You just look at big and you look at small, and the small one does not have the capital to go to court unless he forms an association where everyone puts a little something in it. And with the way the farmers' problems are today—and I am not sure that Kansas is any different from Kentucky in relation to the farming community—we have all kinds of troubles, and if there is 1.4 cent difference in a bushel in 1977 and a 45-cent difference in a bushel in 1983, the difference has to be transportation.

And that is what we are saying here.

There is something about your proposal, Mr. Sexton. You know, a man had two wives, and both of them predeceased him, and before he died, he was asked, what do you want to do, and he said bury me between the two but tilt me toward Tillie. And I am tilting toward Mr. Sexton and what he is trying to do here a little bit. I still cannot follow you, Mr. Oman, about how it is so much better for the shipper, and particularly the small shipper, under present day conditions.

If you could explain that to me, I will be glad to accept it.

Mr. Oman. I have been in transportation and distribution for about 14 years, and specifically in grain for 4, and I still struggle to some extent in understanding the total dynamics of the marketplace. But from my perspective—and I have an opportunity to view a lot of grain transactions, contracts, and marketing distribution systems, and I concur with the study that there is no real evidence that small shippers have been hurt by contract ratemaking.

Senator Ford. Well, I am going to send you some more papers.

Mr. Burrill, how many cars do you ship a day?

Mr. Burrill. I would guess three to four.

Senator Ford. Well, Mr. Bollard said he was not very big. None of his locations ship more than 20 per day or something like that. So that is quite a contrast.

From how many locations do you ship?

Mr. Burrill. One.

Senator Ford. That is all I need to know.

Mr. Bollard, From how many locations do you ship?

Mr. Bollard. One hundred twenty-three.

Senator Ford. And no more than 20 cars per location?

Mr. Bollard. I may add, though, Senator, I would guess that most of our saw mills are around the same size as Mr. Burrill's. We do have some larger complexes, but most of ours are pretty much the size of his.

Senator Ford. But 20 times 100 plus does show quite a difference.

Now, Mr. Bollard, I was interested in reading the letter at the end of your testimony today, which is four pages damning the Staggers Act and what is wrong with it, and saying that the railroads ought to clean it up; or otherwise they are going back to reregulation.

Mr. Bollard. No, sir. That was not what it said.

What it said was that the railroads should cleanup their act as to how they operate under Staggers.

Senator Ford. Well, you sure set out a lot of things here that we have been trying to cleanup in this legislation. We are not contesting the market dominance concept in rate proceedings, abandonment where necessary, an immediate review of the joint rates, and so forth. There are four pages, Mr. Chairman. I think the witness who supports the Staggers Act as it presently is gives us an opportunity to place in the record the changes that are absolutely necessary.

Senator Packwood. Mr. Burrill, one question. All of the other witnesses here, and most of the other people that have testified on the Staggers Act have not complained too much about the concept of contracts. They want them revealed, they would like to know more about them, but you are one of the few that has simply said in my industry I do not think contracts work at all and should not be allowed. Big haulers, small haulers, it would not matter.

Expand again as to why not.

Mr. Burrill. When we first started talking about this, we were talking about contract disclosure, and we asked ourselves, OK, if I came back here and told you our story and you were to tell me that, OK, you can have anything you want in the way of contract disclosure, tell us what you want, OK, we considered that. The facts are that, well, all of the lumber that we shipped by rail goes

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in boxcars. Boxcars are completely deregulated. Disclosure would do nothing for me, absolutely nothing. And small companies like ours, we cannot afford to have a gentleman like this one sitting next to me, you know, even our small associations only have 10 members. We cannot afford to hire somebody like that. And the impossibility of tracking through even on the flatcar contracts, it just is not going to work.

The CURE legislation we support, but we do not feel it goes far enough. It is not going to solve our problems.

I think, Senator Long, you were right on course, and Senator Ford, on the problems of the small versus the large. This gentleman here has put together a document that supports our point of view as people who feel that the regulations need to come about to change the Staggers Act. He very eloquently does that.

Senator **Packwood**. Let me make sure I understand, though, what you are saying. You are small enough that it would not matter if you had access to contracts or could find out what was in the contracts, assuming you could afford to find out, and it is expensive. So it would not matter if the contracts were actually published and they were mailed to you every day so you did not have to have your lawyer look at them. What you are simply saying is that in your position, in your business, you need tariffs and regulation, and that contract authority does you no good.

Mr. **Burrill**. We need equity, and that is what it really comes down to.

Senator **Long**. Let me get one thing straight in my mind, if I can, Mr. Burrill.

Now, Mr. Bollard testified that your plant, your individual plant is probably around the same size as many of his plants, is that right?

Mr. **Burrill**. That is right.

Senator **Long**. Now, he is in a position to negotiate 125 plants, a lot of them, where as you, with the market power that you can speak for, are just one little fellow.

Now, I have seen enough as chairman of a monopoly subcommittee at one point in my career to know how that power of speaking for a lot of business can be compared to the power of speaking for just one little plant. Big business has often been in a position to obtain quantity discounts and all sorts of things because it is dealing for a large amount of business as compared to a competitor who is dealing for a small amount in relative terms.

Now, I take it that the kind of thing you would need would be, one, to know what the contract is with let's say, Louisiana-Pacific. Please understand, those are good people. They make a profit and I am happy about it, but at the same time, you would need to know what contract this other fellow has, and then you could have an opportunity for the same type of break.

Now, that would not break—if a carrier has signed a contract with him for 50 of his plants, the same break for you is not likely to break that railroad, is it, if you have the same type of terms and conditions that they gave him?

Mr. **Burrill**. No, it is not.

Senator **Long**. But without a break like that, what you are saying is that it would not do you any good even if you did know what his contract said.

Mr. **Burrill**. That is right. Our company has been trying to negotiate contracts with the Southern Pacific, and they have offered us some rather interesting contracts. One of them that I can recall would have been giving us a contract to a specific city and to a specific customer. So if the contract, say, was to Cleveland, OH, we could ship to Cleveland, to one customer or two customers that were included in the contract, but if another customer in Cleveland wanted to buy from us, we could not sell to him.

Senator **Long**. You need something like a nondiscrimination or an equity clause somewhere in that law to indicate that if they are selling—if they are providing a service to your competitor under a far more favorable arrangement, they ought to give you a comparable arrangement so that you can compete in that same market. That is the kind of thing, I take it, that you need.

Mr. **Burrill**. The railroads tend to operate, I think, with their head in the sand because they held hearings in our area and they told us that contracts were given so that they could increase their business. So I asked them, I said, now, if you were to take a given geographic area, whether it is western Oregon or whatever, and if you were to reduce the rates for one customer in western Oregon and then measure it again after the rates had been reduced, have you really increased the volume? Say that one customer doubles his output. And they said, well, we are not sure. And I said, well, I can tell you that one customer doubled where the rest of us have shrunk, the total volume has not changed, but it is putting the rest of us at a disadvantage and it is moving us further and further into the west. We are one of the very few companies left that can ship to the east coast because of the quality of the product that we put out. But we are being forced out of this market also.

And this latest thing with the Canadian deal with the Burlington Northern, you know, that is now impacting the markets in California that the west coast mills have been pushed back into. We are getting to a smaller and smaller area, and where do we go next?

Senator **Long**. That situation is such that the Canadian Government is giving the Canadian producer a far more favorable rate on the timber on Government land, which is bad enough, and then your Government permits a further discrimination by the railroads to favor the Canadian product. You really have your back to the wall.

Mr. **Burrill**. That is right.

Mr. **Bollard**. Senator, may I say something?

Senator **Long**. Go ahead.

Mr. **Bollard**. What he referred to here, those rates were published and made effective by the Burlington Northern last Thursday. On Friday we had meetings with the Southern Pacific Railroad who canceled participation into California, Arizona, New Mexico of the rates. In other words, you cannot use them to Southern Pacific points, California, Arizona, New Mexico. The Union Pacific also advised me that they are doing the same thing. You cannot use them into California. Therefore, these rates that Mr.

Burrill is talking about are going to be of no benefit to the Canadian producer because they simply will not apply.

Senator **Long**. Well, that may be very good news.

All I am seeking, Mr. Pollard, is just fairness. If you were on the other end of this issue you would be complaining, too, I take it.

My point of view, just sitting here as one on this committee, is that all I want to do is be fair to all concerned, to Louisiana-Pacific as well as the others.

Mr. **Bollard**. Mills that we have, we have a mill just down the road from Mr. Burrill's mill. We ship on the exact same rates that Mr. Burrill does, exact same rates, both served by the Southern-Pacific. We ship on the exact same rate.

Mr. **Burrill**. It is interesting that the two of us are sitting here talking about what we are. The problems are that if we have equity, when we compete with Louisiana-Pacific, it does not make any difference as long as we have equity. If we are shipping on the same rates, then that is fine, that is well and good because then we are able to compete the way we should be able to compete.

There was a recent contract that Roseberg Lumber Co. had that was kicking both of us out of the market, and that one accounted into the Texas markets of nearly $40 a thousand, and we finally got rid of it, but it was only after the Senator became involved and the noise we started making that we were actually able to get Southern Pacific to even admit that it was there. We knew it was there, but they would not admit to it. And that destroys us.

Senator **Packwood**. Gentlemen, thank you very much.

Now we will have on our panel Mr. Texido, Mr. Petruccelli, Mr. Gastler, and Mr. Bush.

Mr. Texido, go right ahead.

STATEMENTS OF WILLIAM J. TEXIDO, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, BRAE CORP.; M.E. PETRUCCELLI, DIRECTOR OF TRAFFIC, PPG INDUSTRIES, INC., ON BEHALF OF PROCOMPETITIVE RAIL STEERING COMMITTEE, ACCOMPANIED BY JOHN F. DONLAN, COUNSEL, PROCOMPETITIVE RAIL STEERING COMMITTEE; HAROLD L. GASTLER, PRESIDENT AND CHIEF OPERATING OFFICER, MISSOURI-KANSAS-TEXAS RAILROAD CO., ON BEHALF OF RAILROADS AGAINST MONOPOLY; AND GEORGE C. BUSH, GENERAL MANAGER, TRAFFIC, LTV STEEL CO.

Mr. **Texido**. Thank you, Mr. Chairman.

Senator **Packwood**. I will ask you to do the same as the other witnesses, abbreviate your statement. It will be in the record in its entirety, and hold yourself to 5 minutes.

Mr. **Texido**. Thank you.

I am the founder and chief executive officer of the BRAE Corp., a major lessor of rail cars to short line railroads. I am speaking today on behalf of the 283 short line railroads represented by the American Short Line Railroad Association, on behalf of the Itel Corp., another major lessor, and on behalf of the BRAE Corp.

Since short line operators from each of the five geographic regions have traveled here today, I would ask that they stand and be recognized.

Mr. Tom Beard of the Stockton Terminal and Eastern in Stockton, CA; Mr. Jack McMullen of the Angelina and Neches River in Lufkin, TX; Mr. Steve Selby of the Green Bay and Western in Wisconsin; Joe Hartle of the Lake Erie, Franklin, and Clarion in Pennsylvania; and Earl Durden, president of the East Tennessee Railway from Dothan, AL.

I would also ask Mr. Paul Loveday, senior counsel of Itel Rail Corp. and Mr. Howard Croft, president of the American Short Line Railroad Association, to stand.

Thank you, gentlemen.

While my comments will focus on the boxcar car hire issue, it should be emphasized that we are also vitally concerned about the cancellation of joint rates, and my written statement addresses that problem in greater detail.

During the 16-month period when the boxcar exemption was in effect, the class 1 carriers cancelled most, if not all, boxcar joint rates. Since the Commission has not reinstated these joint rates, the Staggers Act provisions protecting small railroads against cancellations are meaningless.

Mr. Chairman, I am embarrassed to be here before this committee again, the first time being July 27, 1983. I am embarrassed because my appearance reflects my inability to accomplish what would appear to be a very simple task. That task is to get the ICC to approve the joint proposal which we were able to negotiate at their request with the major parties involved in the boxcar deregulation controversy. Chairman Taylor referred to the Commission's successful efforts in getting parties to reach agreements, yet those agreements are meaningless unless they are adopted by the Commission.

As the subcommittee knows, rail car supply in this country has been plagued by severe shortages up to the recent past. As a consequence, since 1917, the Congress and the ICC have encouraged investments in rail cars through the establishment of car hire rules which would guarantee car owners a fair rate of compensation when the cars were being used by other railroads.

Between the years 1975 and 1980, a period of severe rail car shortages, the organizations for which I was responsible, then or now, raised over some $900 million in capital and purchased over 30,000 rail cars. Most of this equipment was financed through the sale of 15-year equipment trust certificates. The purchase of these certificates was based on the belief that the compensation structure of the car hire system as provided by Congress would be in place for the life of those certificates.

The majority of these cars were leased to short line railroads which desperately needed an adequate car supply. Traffic on these short lines and the operation and the efficiency of those operations increased substantially as a result of this new equipment. Given these circumstances and the industry's increasing reliance on the short line industry, as was repeatedly testified to last Friday, we were shocked when the Commission on May 2, 1983, issued its boxcar order. This order, sponsored by Conrail, dramatically altered the entire framework of car hire compensation to favor the class 1 railroads. The order would have resulted in the immediate bankruptcy of the rail car lessors as well as a number of short lines and their shippers.

In the nearly 3 years which have passed since the Commission's order was announced, we have pursued every avenue to obtain relief from this new, one-sided order. Finally, on June 27, 1984, the U.S. Court of Appeals overruled the Commission's decision as to car hire and joint rates. The Commission appealed, but the court decision was upheld by the U.S. Supreme Court.

Since then we have responded in good faith to the Commission's request to develop alternatives to its boxcar order. In an effort to resolve our differences, we entered into lengthy negotiations with Conrail, the original sponsor of the Commission's order, some 300 short line railroads, and our competitors. These efforts, while very difficult and time consuming, were successful, and on April 25 of this year, a settlement was reached and submitted to the Commission for approval.

It has now been over 6 months, and the settlement still has not been approved. Furthermore, on Friday Chairman Taylor indicated, after 6 months, that a draft of the Notice of Proposed Rulemaking had finally been circulated either that morning or the previous day by the Commission for consideration. We were told that the draft included a number of alternatives. If true, that will only add further delay as the elimination process drags on.

We have done exactly what we have been asked, and yet we have been unable to get the resolution approved. This is the basis for my embarrassment.

We cannot believe that the authors of the Staggers Act intended such a result. On Friday, the Chairman of the ICC said trust us. The Chairman is leaving. My experts tell me that we cannot get this settlement approved before the Chairman leaves in December without your help.

We are faced with starting again in January with a new Commission.

Mr. Chairman, we do not have another 3 years to fight this issue. We need your help now, not next month, not next year, but now. We have negotiated a fair settlement with Conrail as requested by the Commission. Although we have no choice but to continue to fully commit all of our resources to this struggle, continuing controversy can be avoided. We ask the subcommittee to urge the Commission to adopt the settlement immediately.

As you heard from Senator Kasten Friday, this cause has enormous support both in the House and the Senate. We can avoid the unnecessary use of time and resources with your help by getting the Commission's acceptance now, thereby avoiding the need for legislative relief.

Thank you.

[The statement follows:]

Statement of William J. Texido, on Behalf of the American Short Line Railroad Association, Brae Corp. and Itel Rail Corp.

My name is William J. Texido, and I am the Chairman of BRAE Corporation. I am testifying today on behalf of a coalition which consists of the 289 short line railroads represented by the American Short Line Railroad Association and its five regions throughout the United States, and on behalf of BRAE Corporation and Itel

Rail Corporation. Representatives of these organizations have travelled from all parts of the country to be here today. They are:

Mr. Thomas K. Beard, CEO, Stockton Terminal and Eastern Railroad Company; Vice President and Director of the Pacific Short Line Region; Stockton, California

Mr. Jack McMullen, President, Angelina and Neches River Railroad Company; Vice President and Director of the Southwestern Short Line Region; Lufkin, Texas

Mr. Steve Selby, President, Green Bay and Western Railroad Company; Vice President and Director of the Western Short Line Region; Green Bay, Wisconsin

Mr. Joe Hartle, Chairman, Lake Erie, Franklin and Clarion Railroad Company; Director of the Eastern Short Line Region; Clarion, Pennsylvania

Mr. Earl Durden, President, East Tennessee Railway Corporation, representing the Southern Short Line Region; Dothan, Alabama and

Mr. Paul Loveday, Senior Rail Counsel, Itel Rail Corporation, San Francisco, California.

BRAE Corporation, in addition to its other activities, owns and manages a fleet of 13,000 railcars, including 7,500 boxcars. Founded in 1977 in response to one of the nation's most acute railcar shortages, BRAE leases the vast majority of these cars to short line railroads—the carriers consistently injured by recurring car shortages.

Similarly, Itel Rail Corporation owns and manages a total of 13,000 boxcars predominantly under lease to short line railroads. In addition, Itel Rail Corporation owns four small railroads.

My comments concern the Interstate Commerce Commission's boxcar deregulation proceeding. More than two years ago I testified before this subcommittee saying that the Commission's boxcar order was unlawful and unfair. Over a year ago, the courts agreed. The boxcar order was overturned. Despite these developments, this issue continues to haunt the rail industry.

We believe an opportunity now exists to end this four-year controversy. Conrail—the leading proponent of the boxcar deregulation proposal—and the short lines reached a settlement in April of this year which needs only the Commission's approval. I must confess, however, to a certain degree of concern and frustration over the apparent lack of enthusiasm at the Commission to endorse an industry resolution of this problem.

The purposes of my testimony are to (1) refocus this subcommittee's attention on the irreparable harm that will befall the nation's small railroads if an equitable solution to the boxcar deregulation controversy is not adopted; (2) urge this subcommittee to exercise its oversight authority to ensure the settlement proposal now before the Commission is approved without further delay; and (3) report to the subcommittee on the failure of the Commission to properly implement the joint rate provisions of the Staggers Rail Act.

CAR HIRE REGULATION

Congressional responses to the Nation's recurring problem of railcar shortages

As members of this subcommittee know, railcar supply in this country has been plagued by chronic and severe shortages. Historically, the major railroads have been unable or reluctant to invest the capital needed for new rail equipment. This failure to reinvest is in large part due to the extremely low return on capital earned by the rail industry as a whole. As a consequence, the Congress and the Interstate Commerce Commission have encouraged investment in railcars through the establishment of car hire rules which guaranteed car owners an opportunity to earn a fair rate of compensation when their cars were being used by other railroads. This fundamental concept was strengthened by the Congress in the 1966 amendments to the Interstate Commerce Act and the 4R Act of 1976.

More recently, adoption of the Staggers Rail Act of 1980 reaffirmed the Congressional mandate of fair compensation for car hire. The Administration's original rail deregulation bill proposed that section 11122 of the Interstate Commerce Act which guaranteed car owners an opportunity to earn a fair rate of compensation for car hire be repealed. Congress specifically rejected this proposal and left intact the 4R Act requirement that the Commission's regulations "shall encourage the purchase, acquisition and efficient use of freight cars."

Private industry's response to congressional inducements

Congress was successful in encouraging private investment in the rail industry. For example, between 1975 and 1980, the management teams at BRAE and Itel were responsible for the purchase of approximately 30,000 railcars representing over $900 million in rail freight equipment. Most of this equipment was financed over a 15-year period through the use of equipment trust certificates having fixed debt obligations. The majority of these cars were leased to short line railroads which did not have the capital to purchase their own cars and which had historically experienced shortages resulting from an inadequate car supply—inadequate in terms of quantity, quality and design.

Short line railroads which purchased their own cars and companies like BRAE and Itel, which helped to finance short line rail equipment were attempting to meet specific and legitimate transportation needs of shippers on the short line railroad lines. They reasonably relied on the statutory assurances of fair compensation in the 4R Act and the Staggers Rail Act. Boxcar owners—short line railroads or their lessors—entered into long-term commitments premised on the statutory assurance of fair compensation.

The Commission's Boxcar Order

As part of its May 2, 1983 Order deregulating the rates for commodities transported on boxcars, a majority of the Commission drastically altered the framework of car hire compensation to favor the large Class I railroads. First, under the new rules approved by the Commission, large carriers were given the unilateral authority to terminate car hire payments to car owners three days after cars were made empty. Second, carriers were authorized to assess an empty movement charge of 35 cents per mile.

The Commission in effect placed two new weapons in the arsenal of the large railroad. The short line railroads and their shippers could be forced to accept the terms dictated by the large carriers. For example, the Little Rock and Western Railroad—a short line railroad—compared the revenue earned on a typical boxcar shipment under present rules and under the Commission's new car hire rules. This short line determined that the earnings per trip on each boxcar would fall from the positive $120 to a net loss of $233. For the parent shipper, Green Bay Packaging Corporation, this would mean a loss of nearly $1 million in annual revenues.

Short Line coalition efforts to obtain relief from the boxcar order

In the nearly three years which have elapsed since the Commission's boxcar order was first announced, short line railroads, their shippers and car owners have appealed to every available forum to obtain relief from the boxcar order. Shortly after the Commission announced its decision, we formally petitioned the Commission to reconsider its decision as to the Class III carriers and also to stay its order. The Commission denied both petitions, although it acknowledged that "Short line railroads . . . may have good cause to be concerned about the near term effects" of the boxcar order.

On two separate occasions, with the effective date of the boxcar order fast approaching and our appeal of that order still pending, we asked Congress to step in and legislate a stay of the decision for small railroads. Reluctantly, and then only when faced with the imminent threat of legislation, the Commission postponed the effective date of the order for short line railroads.

Court reversal of boxcar order

On June 27, 1984, the U.S. Court of Appeals for the District of Columbia overturned the Commission's decision as to car hire and joint rates. The Court ruled that the Commission exceeded the scope of the Staggers Rail Act exemption provision in adopting the new car hire rules. The new car hire rules were found to have "skewed the initial economic relationship in favor of the destination carrier." *BRAE Corp.* v. *United States,* 740 F.2d 1023, 1056 (D.C. Cir. 1984), cert. denied,——U.S. ——, 105 S. Ct. 2149 (1985). The Commission appealed, but the appellate court decision overruling the Commission was upheld by the U.S. Supreme Court.

Conrail/Short Line settlement proposal

Following the Court reversal, the ICC opened a new proceeding (Ex Parte 346, Sub-No. 19) to consider alternatives to its boxcar car hire order. The short line coalition reasserted its opposition to the application of the now-overturned car hire rules to small railroads and, along with a number of other parties, suggested a number of alternative solutions.

In an effort to resolve our differences without resort to further litigation, we entered into lengthy negotiations with the large railroads. These efforts, while difficult and time consuming, were successful. On April 25th of this year, Conrail, the short lines, BRAE and Itel reached a settlement. The key features of the settlement are as follows:

1. The empty mileage, storage reclaim and bilateral agreement negotiation provisions of the original boxcar order would be readopted by the Commission as to Class I and affiliated Class II carriers.

2. Any boxcar which, on December 30, 1983, was owned or leased by a Class III carrier or a Class II carrier not affiliated with a Class I carrier and which bears the reporting marks of such carrier would be grandfathered. The current car hire and car service rules would continue to apply to grandfathered boxcars.

3. The joint rate and through route provisions of 49 U.S.C. 10705 and 10705a would continue to apply to Class III railroads.

4. No freight rate made effective after April 1, 1985, that applies to Class III boxcar traffic may discriminate on the basis of car marks, the care hire rate, or any car hire discounts.

Action Requested of the Subcommittee

It has now been over six months and the Conrail/Short Line settlement has not been approved by the Commission. As a businessman, and as a partner with the short line railroads, the continuing delay in obtaining ICC endorsement of the settlement so that this issue can be resolved once-and-for-all is intolerable. We cannot plan for the future and the uncertainty impededs the efficient operation of short line carriers. We cannot believe the authors of the Staggers Rail Act intended such a result.

The continuing controversy over boxcar deregulation has been a tremendous drain on the resources of the rail industry, the Commission and Congress. Further delay can only disturb this delicate compromise. Although we have no choice but to continue fully to commit our resources to this struggle, there is a window of opportuntiy now available to achieve an equitable solution to this longstanding dispute. We ask the subcommittee, in the exercise of its oversight function, to urge the Commission to adopt the settlement now before it, so that the need for remedial legislation can be avoided.

JOINT RATE REGULATION

The Commission has failed to implement the joint rate provisions of the Staggers Rail Act

The short line coalition which I represent shares the deep concerns of others about the Commission's failure to implement properly the Staggers Rail Act joint rate provisions. The Courts have repeatedly criticized the Commission for its failure in this regard.[1] Unfortunately, in spite of these court reversals, no solutions have been forthcoming from the Commission and joint rates have not been reinstated. Consequently, the Commission has effectively deregulated railroads in ways that Congress specifically declined to endorse at the time the Staggers Rail Act was under consideration.

The Staggers Rail Act grew out of a proposal to eliminate totally the Commission's authority to prescribe joint rates. At hearings during 1979 this approach was the subject of intense opposition from a broad group of witnesses. Congress rejected earlier proposals to deregulate joint rates and instead provided a specific means—49 U.S.C. § 10705a—by which large railroads could solve their alleged problems. Section 10705a provides a specific and narrowly defined provision for surcharges and cancellations of unprofitable joint rates.

The Lee Amendment, which became part of 49 U.S.C. § 10705a, was specifically added to protect short line railroads. Its sponsor stated:

"Most of my attention has been directed to section 301, joint rate surcharge and cancellations, because that is the area where there is room for the greatest mischief. I want to be clear, however, that it is our intent to promote development of class II and class III carriers and other sections of this legislation are not to be used by the Interstate Commerce Commission or any other entity in a fashion that intends an adverse impact on one or more class II or class III carriers.

"As a general guideline, I will cite some examples of the kinds of actions that would not be acceptable as tools against class II and III railroads by class I carriers. In this bill we broaden the exemption clause creating a simpler standard. *In no case should the exemption clause be allowed in a circumstance that would allow a large carrier to utilize its market power to squeeze a smaller carrier on a joint rate or division* or to force a de facto cancellation. In other words the exemption clause should never be used to "end run" the joint rate provisions contained in section 301.

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[1] *Chesapeake & Ohio Ry. Co.* v. *U.S.*, 704 F.2d 373 (7th Cir. 1983); *Green Bay & Western R.R. Co.* v. *U.S.*, 644 F.2d 1217 (7th Cir. 1981); *BRAE Corp.* v. *U.S.*, 740 F.2d 1023 (D.C. Cir. 1984), cert. denied,——U.S.——, 105 S. Ct 2149 (1985); and *Detroit, Toledo and Ironton R. Co.* v. U.S., 725 F.2d 47 (6th Cir. 1984).

"The above examples are by no means a complete list. Simply put, we do not intend that the various sections of this legislation be used so that the expanded power and flexibility given large carriers can be applied against class II and class III carriers in an adverse fashion that would impair a smaller carrier's ability to attain financial health." 126 Cong. Rec. H. 8553 (Sept. 9, 1980). [Emphasis added].

The Commission and the large railroads have in fact been engaging in an end run around the provisions of the Staggers Rail Act dealing with joint rates. As the Commission itself has acknowledged, it has: ". . . abandoned its former policy of suspending tariffs that cancelled joint rates and now routinely allows such tariffs to go into effect. Accordingly, section 10705(e) now controls the vast majority of joint rate cancellations. *As a result, section 10705a—and with it the Lee Amendment—is rarely employed and of little significance.* "Reply Brief for the ICC, page 3 (April 1985); *ICC* v. *BRAE Corporation*, No. 84-550." [Emphasis added].

In a thorough review of the post-Staggers Rail Act law dealing with cancellations of joint rates, the District of Columbia Circuit Court of Appeals in *BRAE* v. *United States* was highly critical of the Commission's cavalier approach. The following excerpts from that opinion illustrate the problem:

"The first problem with the ICC joint rate exemption is the Commission's failure to adequately explain its crucial assertion that large long-haul carriers will not close efficient routes of small short-haul carriers. After admitting the large carriers have an incentive to close off efficient competing routes to gain monopoly power over a haul from a given origin to a given destination, it simply dismissed this possibility as unlikely." 740 F.2d at 1047.

Because, therefore, the ICC failed to fully consider the ability of large carriers to gain unfair joint rate divisions by using monopoly power over carriers whose participation in through rates is captive to this monopoly, we remand the rate exemption as it applies to joint rates. *Id.* at 1050.

"With respect to joint rates, the text and legislative history of the Staggers Act demonstrate that Congress thought a fair division of joint rates was an important means of carrying out the rail transportation policy. The Commission's total failure to consider the effect of joint rate exemption on this division was therefore arbitrary and capricious." *Id.* at 1051.

The Commission simply has not been giving adequate attention to the Congressional remedies for solving problems related to joint rates and joint rate cancellations.

The large carriers uniformly claim that they have not and do not intend to cancel efficient joint rates or routes and do not intend to force changes in the divisions of joint rates that small railroads currently receive. However, during the 16 months that the boxer exemption was in effect, large railroads claim that all boxer joint rates with Class III railroads were cancelled. The large railroads justify these cancellations by explaining that so far they have not changed the divisions or shares the small railroads receive for joint line movement. However, they also contend that their major goal in eliminating joint rates and relying upon other concepts for handling joint line traffic is to give them freedom to adjust divisions unilaterally. This is the primary reason they eliminated the joint rates while the exemption was in effect. If there is no joint rate in effect, the Staggers Act provision protecting small railroads against unjust cancellations is effectively nullified.

Congress should exercise its oversight authority to ensure the proper implementation of the joint rate provisions of the Staggers Rail Act

From the foregoing we believe it is clear that the ICC's failure to properly implement the Staggers Rail Act has deprived small railroads of the vital joint rate protections enected by Congress. The ICC's practices and polices have been promoting the interests of large railroads to the detriment of the small railroads. The Commission has followed this course in spite of the fact that it has been criticized by the courts for failure to implement the law adequately.

We have not abandoned the hope that the Commission on its own or [illegible] stimulus from this subcommittee will provide a means for small railroads to reestablish joint rates which have been cancelled. The Commission must also enable small railroads to participate in new joint rates which will receive the protection embodied in the Staggers Rail Act. The Commission needs to refocus on promoting the national rail transportation policy as a whole and not just the seven largest rail systems. If the Commission does not respond promptly with actions that provide solutions for small railroads, then remedial action will be necessary and it may have to come from the Congress.

Thank you.

Senator PACKWOOD. Thank you.

Mr. Petruccelli.

Mr. PETRUCCELLI. Mr. Chairman, my name is Michael E. Petruccelli. I am the general traffic manager for PPG Industries, Inc., Pittsburgh, PA.

I appear today before this committee as an officer of the procompetitive rail steering committee and not as a representative of PPG Industries.

With me this morning is Mr. John F. Donlan, counsel for the procompetitive committee.

The members of our committee are engaged in industries which are tied to the railroads by production facilities designed for rail service and distribution systems geared to long distance, high volume shipments which generally are not adaptable to transportation by truck or intermodal service. A number of our commodities, due to their nature, can only be transported by rail. Therefore, a high percentage of our members' shipments are captive to the railroads and dependent upon rail-to-rail competition as a protection against monopoly rail pricing and service abuse.

I would like to make it clear that for the most part we believe the Staggers Rail Act has worked very well, but only where rail-to-rail competition exists. An inherent part of the action of Congress in reducing the regulation of the railroads was the parallel requirement for encouragement in increasing of rail-to-rail competition. Unfortunately, where rail-to-rail competition has not been available, the ICC has not fulfilled the balance contemplated by Congress in 1980.

In fact, the track record of the Interstate Commerce Commission in implementing the Staggers Rail Act reveals an aggressive hostility toward this objective of preserving, promoting and strengthening rail-to-rail competition.

There are a number of ways that the ICC could have promoted competition such as the use of reciprocal switching to provide competitive rail service, the granting of the right to utilize railroad terminal facilities and the providing of competitive service through joint rates and through routes. On the contrary, the Commission, far from preserving, promoting and strengthening railroad competitive access, has gone out of its way to frustrate increased rail-to-rail competition. We have cited a number of disturbing examples of this in our prepared statement.

The latest example is the *Midtec* case where the following scenario occurred. First, the administrative law judge entered a decision granting an application both for reciprocal switching and the right to utilize terminal facilities. The Commission Review Board upheld that decision as to reciprocal switching but reversed as to the use of terminal facilities not on the merits but on the judgment that section 11103 did not provide for both remedies. However, the full Commission itself completely erased the granting of any relief. It even went further and specifically reversed an important part of its decision in the *Delaware* and *Hudson-Conrail* case which held that reciprocal switching would be determined by a rail-to-rail competitive test.

The *Midtec* decision makes clear that, left to its own devices, this committee will simply not preserve, strengthen or promote railroad competitive access.

The procompetitive committee has concentrated its efforts specifically on this issue and has formulated a legislative proposal designed to resolve this problem. The procompetitive committee is aware that others also have been concerned with this issue of railroad competitive access. Specifically, we note the provisions of section 7 of S. 477, the CURE bill, which has much in common with the procompetitive committee's legislative proposal. While there are some differences in these proposals, I am sure that such differences can be reconciled. For the present, the procompetitive committee supports in principle the concepts contained in section 7 of S. 477.

It is clear that the ICC is unwilling or unable to implement the mandate of the Staggers Act to preserve, promote and strengthen rail-to-rail competition. The members of the procompetitive committee and the public have been and will continue to be adversely affected unless Congress takes prompt action. The response of the ICC to this vital issue over the past 5 years leaves us no choice but to seek clarifying legislation.

Timing is crucial. Five years ago there were twelve major rail systems, and today, as a result of mergers, there are only seven. Rail-to-rail competition must be preserved and promoted now. Tomorrow may be too late.

On behalf of the procompetitive rail steering committee, I thank you for the opportunity of appearing here before this subcommittee and presenting our views today, sir.

[The statement follows:]

STATEMENT OF MICHAEL E. PETRUCELLI ON BEHALF OF PROCOMPETITIVE RAIL STEERING COMMITTEE

My name is Michael E. Petruccelli. I appear for the Procompetitive Rail Steering Committee, which I serve as Vice President. I am appearing today before this Committee as an officer of the Procompetitive Rail Steering Committee and not as a representative of PPG Industries, Inc. I am General Traffic Manager for PPG Industries, Inc. My business address is One PPG Place, Pittsburgh, PA 15272.

The Procompetitive Rail Steering Committee, which I shall sometimes refer to for convenience as the Procompetitive Committee, is an incorporated organization comprised of widely diversified companies in the United States which are substantial users of railroad transportation. The Procompetitive Committee members are listed below:

Allied Corporation
American Iron and Steel Institute
Amoco Chemicals Company
Cargill, Incorporated
Celanese Chemicals Company, Inc.
CF Industries, Inc.
Chrysler Corporation
Colt Industries. Inc.
Ethyl Corporation
Ford Motor Company
FMC Corporation
ICI Americas, Inc.
International Paper Company
Libbey-Owens Ford Company
Manville Service Corporation
Monsanto Company
Nalco Chemical Company
Occidental Chemical Corporation
Olin Corporation
Owens-Illinois, Inc.
PPG Industries, Inc.

Reichhold Chemicals Inc.
Tennessee Eastman Company,
Division of Eastman Kodak
Union Carbide Corporation
Uniroyal, Inc.
Wyandot Dolomite, Inc.

Our members appreciate very much the opportunity to testify in these hearings. In accordance with the wishes of the Chairman I will separately summarize the views of the Procompetitive Committee in a short statement. However, we request that our full statement which has been distributed to the Subcommittee and to others concerned be made part of the record here being made.

I would like to make it clear that for the most part the Staggers Rail Act has worked very well, where rail-to-rail competition exists. Where this rail-to-rail competition is not available the ICC unfortunately has not achieved the balance contemplated by Congress in 1980.

In presenting our testimony in these Staggers Act oversight hearings I think it is helpful to consider how and why the Procompetitive Committee came into being. The members of our Committee are engaged in industries which are tied to the railroads by production facilities designed for rail service, and distribution systems geared to long-distance, high-volume shipments, which generally are not adaptable to transportation by truck or intermodal service. A number of our commodities, due to their nature, can only be transported by rail. Any attempt to change our members' dependence on rail service, even where physically possible, could not be accomplished without massive capital expenditures and prohibitive increases in operating costs. In addition, the products shipped by some members of the Procompetitive Committee are fungible, bulk and low-value goods with rail transportation costs representing a significant percentage of their delivered value. Here again, a high percentage of our shipments is captive to the railroads and dependent upon rail-to-rail competition as a protection against monopoly rail pricing or service abuse. The members of the Procompetitive Committee are vitally interested in a competitive, market-disciplined and efficient rail system able to move the nation's commerce and support the nation's defense needs.

One of the key objectives of the Staggers Rail Act is the preserving, promoting and strengthening of rail-to-rail competition. The Procompetitive Committee believes the strengthening of rail-to-rail competition is a vital part of the program contemplated and incorporated in the Staggers Act and is a critical prerequisite to the substantial deregulation of the nation's railroads provided by the Act. At the same time the balanced administration of the precompetitive features of the act is absolutely essential to protect the shipping public from the abuse of railroad market power.

Since enactment of the Staggers Rail Act to the present time the members of the Procompetitive Committee have been shocked and chagrined at the indifference of the Interstate Commerce Commission to the subject of rail-to-rail competition, as the Agency proceeded to implement the Staggers Rail Act. Actually, the attitude of the Commission on the subject of rail-to-rail competition has been and is even more harmful than mere indifference. In the view of the Procompetitive Committee the Commission has seemed bent upon ignoring or frustrating the objective of healthy rail-to-rail competition. The Commission has strained to come up with reasons whereby it would not interfere with individual railroad acts to destroy rail-to-rail competition, and whereby it would not grant aggrieved shippers or railroads competitive rail access to origin, intermediate or destination markets.

It was under these circumstances that the members of the Procompetitive Committee determined to concentrate their energies upon obtaining the relief, contemplated under the Staggers Rail Act, in the sphere of railroad competitive access.

Commencing approximately in mid-1983 the members of the Committee came together to discuss ways and means of achieving the preservation, promotion and strengthening of rail-to-rail competition. As one part of their deliberations the Committee had the benefit of a report entitled "Preserving and Promoting Rail Competition" prepared by Dr. Curtis M. Grimm, Assistant Professor—Transportation, Business and Public Policy, College of Business Management, University of Maryland, released in May of 1984.

In his Conclusions Dr. Grimm stated:

". . . the very success of rail regulatory reform may well hinge on preserving and promoting competition. Inadequate interrail competition, in the absence of strong regulatory constraints, will surely foment undesirable and expensive re-regulation.

"The policy implications are clear: interrail competition must be encouraged by public policy initiatives in every relevant area . . ." (P. 33)

* * * * * * *

"Thus, public policy should prevent anticompetitive joint rate and route as well as reciprocal switching cancellations, aggressively promote additional reciprocal switching and other competitive access. . ." (p. 34)

Increasingly desperate for relief, after thorough discussion over an extended period of time, working with legal counsel, the Procompetitive Committee prepared its own legislative proposal limited specifically to the issue of railroad competitive access. The text of that legislative proposal is attached as Appendix B. A succinct commentary or explanation of the legislative proposal is attached as Appendix C.

During the past 2 years I and other members of the Procompetitive Committee have made numerous presentations or participated in debates on the issue of railroad competitive access. The Procompetitive Committee has thus far delayed taking steps to progress its legislative proposal in the Congress. Nevertheless, the Procompetitive Committee stands steadfast in its conviction that rail-to-rail competition is crucial and that Congress should leave no doubt of its desire that rail-to-rail competition, under the Staggers Rail Act, should be preserved, promoted and strengthened. It is the further conviction of the Procompetitive Committee that this vital subject cannot be left to the discretion or to the whim of the Interstate Commerce Commission. It is the Procompetitive Committee's judgment that this objective must be accomplished by clarifying legislation. The track record of the Interstate Commerce Commission leaves no doubt on this score.

I might elaborate on the matter of the total disenchantment of the Procompetitive Committee with the performance of the I.C.C. in implementing the rail-to-rail competition objectives of the Staggers Rail Act. Probably the most recent and most blatant example is the Commission's Decision, served July 17, 1985, in Docket No. 39021, *Midtec Paper Corporation* v. *Chicago & North Western Transportation Company*. In this case Midtex Paper Corporation and the Soo Line Railroad sought to have the Soo serve Midtex's paper mill at Kimberly, Wisconsin by using the North Western's terminal facilities under 49 U.S.C. § 11103(a) and by requiring the creation of a reciprocal switching agreement with the North Western under 49 U.S.C. § 11103(c). The initial decision of the Administrative Law Judge granted the relief sought. A Commission Review Board, acting in an appellate capacity, affirmed the requirement to negotiate a reciprocal switching agreement but reversed the alternative requirement to negotiate a trackage rights agreement, holding that section 11103 does not authorize dual relief.

The matter then came before the Commission. All relief was denied. There was a vigorous, almost bitter dissent, by Chairman Taylor. Commissioners Simmons and Lamboley also dissented.

A reading of the *Midtec* Decision, in the view of the Procompetitive Committee, indicates that the Commission there truly went out of its way, by tortuous reasoning, to deny the railroad competitive access relief there sought.

There is a special additional wound inflicted by the *Midtec* Decision. In I.C.C. Finance Docket No. 29802, *Delaware & Hudson Railway Company* v. *Consolidated Rail Corporation*, the Commission had granted relief. One of its specific findings there had been:

". . . The clear language and legislative history of section 11103(c) show that it was Congress' intent that we focus on rail-to-rail competition in determining whether reciprocal switching agreements are necessary to provide competitive rail service . . ." [367 I.C.C. at 727]

As one of the blows the Commission struck in the *Midtec* Decision the Commission reversed this earlier ruling in the *Delaware & Hudson* case. The *Midtec* case is now pending before the U.S. Court of Appeals for the District of Columbia Circuit. Several shipper organizations have intervened in opposition to the Commission's Decision. The *Midtec* Decision reveals dramatically why the Procompetitive Committee has little faith in the Interstate Commerce Commission and is seeking legislative clarification on the issue of railroad competitive access.

This type of grievance on the part of shippers has been longlasting. In ICC Finance Docket No. 29883, *Universal Forest Products Inc.* v. *Seaboard Coastline Railroad Company*, the Commission Review Board had found the performance of reciprocal switching by the Seaboard for the Southern at Moultrie and Kingwood, Georgia to be practicable, in the public interest and necessary to provide competitive rail service. The Commission, Division 1 reversed in its Decision served June 23, 1983. Among other things it referred to 49 U.S.C. § 11103(c) as "a little used provision of the Act." (Mimeo Sheet 4) The Review Board had noted that Section 11103(c) had been added to the Interstate Commerce Act by the Staggers Act. [Section 223] In the evolution of the Staggers Rail Act the House Report (H.R. Rept. 96-1035, 96th Congress, 2d Sess. 67) 1980 observes that:

". . . reciprocal switching has been limited to situations where competition between rail carriers is not threatened. *The Committee intends for the Commission to permit and encourage reciprocal switching as a way to encourage greater competition* . . ." (Emphasis added) (p. 67)

Here the Commission was dealing with points only 2.4 miles distant from each other. The mind-set of the Commission revealed in the Decision reflects almost a fixation to frustrate reciprocal switching and thereby rail-to-rail competition.

Another distressing example comes readily to mind. In ICC Docket No. 38891, *Central States Enteprises, Inc.* v. *Seaboard Coast Line Railroad Company*, the Commission's Review Board had granted a shipper's request for reciprocal switching. However, the Commission in its Decisions served May 15, 1984 reversed that Decision. Here the Commission indulged in semantics as to whether Woodacre, Georgia is within the Switching limits of Camilla, Georgia. Here the distance was approximately 1.4 miles from the nearest interchange point. The two involved railroads, the Seaboard Coast Line and Southern published reciprocal switching tariffs for certain movements at Camilla and regularly interchanged traffic that must move more than 1.4 miles from the interchange. Nevertheless the sought reciprocal switching was denied by the Commission. Again, there was a virgorous dissent by ICC Chairman Taylor. The Commission appears determined in every way possible to place the sharpest limits on the availability of railroad competitive access.

The ICC reveals a similar attitude in its treatment of cancellation of joint single-factor through rates. In its Decision in No. 38676, *Changes In Routing Provisions—Conrail—July, 1981*, served March 22, 1982, the Commission permitted to go into effect (with a single exception) massive cancellation of joint single-factor through rates via approximately 100 interterritorial gateways. In addition on movements to or from points in Official Territory which Conrail can serve directly, through seven major gateways which Conrail reaches directly, Conrail restricted its participation in the joint rates to movements by Conrail direct (on the portion within Official Territory). Conrail added many additional restrictions on its participation in joint single factor through rates. It is inconceivable that anyone would reasonably contend that genuine and meaningful attention was given to preserving competitive railroad access in this type of massive meat-axe joint rate cancellations.

The Commission's Decision was reversed by the U.S. Court of Appeals for the Seventh Circuit on April 4, 1983. (704 F. 2d 373) On remand, additional evidence and argument have been taken and the case is pending for decision. In the interim, with the single exception mentioned, the enormous numbers of cancellations of joint rates have remained in effect.

Another case in point is ICC Docket I.&S. No. 9258, *Routing Between Stations Served By Conrail, November 1982.* By Decision served November 12, 1982 Commission, Division 1, Acting as an Appellate Division, entered an order of suspension and investigation of tariff schedules published by Conrail. With limited exceptions the instant tariff provisions provided that routing on traffic originating and terminating at stations served by Conrail would apply only via Conrail. In its suspension and investigation order the Commission stated:

"We have considered the issues raised by the parties in Suspension Case No. 70949. Because of the legal ambiguities relative to the agreements between the railroads and because of the potential for injury to the smaller railroads if the joint rate cancellation is ultimately found by us to be unlawful, it is our decision that the joint rate cancellation proposal should be suspended and investigated."

Subsequently by Decision served January 7, 1983, on appeal by Conrail, the Commission entirely vacated the order of suspension and also entirely vacated the order of investigation so that the proceeding was allowed to die on the vine and no further investigation by the Commission was pursued. The Commission indulged in superficial distinctions between cancellation of joint rates and closing of routes as well as in totally theoretical speculation as to the level of rates which might follow the cancellation of the single factor joint rates. In a short period of time this practice of mass cancellations of joint rates and routes spread like wildfire across the rail systems, affecting all parts of the country.

The point the Procompetitive Committee wants particularly to stress here is the gross indifference of the Commission to the policy of the Staggers Rail Act to preserve, promote and strengthen rail-to-rail competition.

Out of these experiences, and others, it is the considered judgment of the Procompetitive Rail Steering Committee that legislative clarification is essential to compel the Commission to play its role in preserving, promoting and strengthening rail-to-rail competition.

I am sure that the members of this Subcommittee are aware that the exercise of the Commission's suspension and investigation power with respect to railroad anti-competitive action is now so rare as almost to become a media event, when it occurs. The Commission must be placed back on the track insofar as railroad competitive access is concerned.

The Congress conferred enormous benefits upon the railroad industry in enacting the Staggers Rail Act. However, the Congress did so with both the requirement and the expectation that rail-to-rail competition would be promoted and would be increased. In fact, rail-to-rail competition has actually decreased.

It is here pertinent to note that the Procompetitive Committee has not been alone in its concern about the subject of railroad competitive access. The Procompetitive Committee is aware of the provisions of section 7 of S. 477 introduced in the Senate in February under the sponsorship of Senators Andrews, Long, Stevens, Ford, DeConcini, Johnston, Melcher, Gore and Bentsen. This is the so-called CURE bill. The language of Section 7 of S. 477, as a matter of principle, recongnizes the problem of preserving and strengthening railroad competitive access and seeks to provide specific methods for solving that problem.

There are strong points of similarity between the Procompetitive legislative proposal and Section 7 of the CURE bill. There are some points of difference. The Procompetitive Committee is confident that the points of difference can ultimately be reconciled. At this stage, in testifying in these Staggers Rail Act oversight hearings, the Procompetitive Committee supports in principle the concepts embodied in section 7 of S. 477, the CURE bill. If vigorous, healthy rail-to-rail competition is not preserved, promoted and strengthened the Staggers Rail Act will in that respect have proved severely injurious to important segments of the shipping public such as the members of the Procompetitive Rail Steering Committee.

This is especially the case as we all observe the evolution of the nation's railroads. There are now seven powerful and dominant rail systems. If the prospective merger of the Santa Fe and the Southern Pacific is consummated this will result in one less rail system to provide railroad competition. It is interesting to note that the Department of Justice has expressed strong concern as to the anticompetitive aspects of this particular merger. In addition, the uncertainties as to the future of Conrail, now before the Congress, present the possibility of an even further reduction in the number of competing rail systems. The greater the power of the individual railroad systems the greater the risk to the members of the shipping public arising from actual or potential abuse of railroad market power including the prevention of competitive railroad access. The Procompetitive Committee does not believe Congress, in enacting the Staggers Rail Act, intended that these few powerful railroad systems were to operate insulated from competition of other rail carriers, or were to be free to deny their shippers or receivers competitive access to origin, intermediate or destination markets. Without assurance of continuing, vigorous rail-to-rail competition those shippers and receivers will frequently be helpless in the face of exploitation by these few powerful railroads through the exercise of unbridled market power

In concluding this testimony I want to reiterate strongly the view of the Procompetitive Rail Steering Committee that the preserving, promoting and strengthening of rail-to-rail competition was and is, in our view, one of the fundamental objectives of the Staggers Rail Act. The achievement of this objective is clearly in the public interest.

The members of the Procompetitive Committee have been and are totally disenchanted with the implementation of the Staggers Rail Act by the Interstate Commerce Commission in the sphere of rail-to-rail competition. The actual and the potential abuse of railroad market power must be brought under control. We are convinced this can best be accomplished by clarifying legislation.

In principle the Procompetitive Committee supports the concepts contained in the treatment of enhancement of competition in section 7 of S. 477 while we continue to support as well the additional elements in our own legislative proposal.

The Procompetitive Rail Steering Committee stands ready to work with this Subcommittee and its Staff in achieving a genuine solution to the problem of railroad competitive access.

The timing is crucial. Rail-to-rail competition must be preserved and promoted now. Tomorrow may be too late.

Thank you again, Mr. Chairman, for the opportunity to present these views.

APPENDIX B

PROCOMPETITIVE RAIL STEERING COMMITTEE

Legislative Proposal

A BILL

To amend Subtitle IV of title 49, United States Code, to promote and strengthen competition between and among the nation's railroads.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Short Title

Section 1. This Act may be cited as the "Railroad Competition Act of 1984."

Statement of Purpose

Section 2. The purpose of this Act is to promote and strengthen competition between and among the nation's railroads in order to implement fully the rail transportation policy in Section 10101a, Chapter 101, Subtitle IV, title 49, United States Code.

Rail Transportation Policy

Section 3. Subtitle IV, Chapter 101, title 49, United States Code, Section 10101a, sub-section (5) is amended to read:

(5) to foster sound economic conditions in transportation and to ensure effective competition and coordination both between and among rail carriers and between rail carriers and other modes.

Through Route/Joint Rate Cancellation

Section 4. Subtitle IV, Chapter 107, Subchapter I, title 49, United States Code, is amended by changing sub-sections (f), (g) and (h) of Section 10706 to read (h), (i), and (j), respectively, and by inserting a new sub-section (f) to read:

> (f) Notwithstanding all other provisions of Subtitle IV of this Title, cancellation by any rail carrier of any through route and/or joint rate where the purpose or effect has been, is, or will be the substantial lessening of competition between and among railroads, creation of monopoly, or restraint of trade in railroad freight transportation is prohibited. Any rail carrier, shipper, receiver or other party adversely affected by such cancellation, actual or prospective, shall have the right to obtain a permanent injunction against such cancellation upon application to any district court of the United States located in the area in which the cancelling carrier provides or has provided rail transportation via such through route or under such joint rate. Such injunctive relief shall include rescission of any such cancellation which shall previously have become effective.

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Establishment of Competitive Joint or Proportional Rates

Section 5. Subtitle IV, Chapter 107, Subchapter I, title 49, United States Code, Section 10705, is amended by inserting after new sub-section (f) the following new sub-section (g):

(g) Notwithstanding all other provisions in this section, in order to achieve the objective of greater intramodal railroad competition any rail carrier providing service under a single line rate, or a joint line rate, on a particular category of traffic, between an origin and destination shall, upon request of a railroad having an actual or practicable interchange connection with said rail carrier between said origin and destination, either participate in at least one competitive joint rail rate via said interchange on such traffic with said connecting rail carrier between said points or shall publish a competitive proportional rate on such traffic to or from said interchange point. Said joint rate or proportional rate shall be conclusively deemed competitive if the ratio of revenue to variable costs realized from the division of the joint rate or from the proportional rate is no higher than that realized from the rail carrier's single line rate, or its division of said joint rate, between said origin and destination. Any shipper or receiver desiring competitive rail service between said origin and destination shall also have standing to request and obtain such alternative competitive railroad rate and service under the conditions above specified.

Reciprocal Switching

Section 6. Subtitle IV, Chapter 111, Subchapter I, title 49, United States Code, Section 11103(c) is amended by changing sub-section (c) (2) to sub-section (c) (3), by deleting sub-section (c) (1) and inserting the following:

(c) (1) Upon petition of any interested rail carrier, shipper, receiver or other party directly impacted, the Commission shall require rail carriers to enter into reciprocal switching agreements, where it finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide alternate competitive rail service. The Commission shall take final action upon such petition no later than one hundred twenty days after the filing of such petition with the Commission. The carriers entering into such an agreement shall establish the conditions and compensation applicable to such agreement in order to provide such alternate competitive rail service, but, if the carriers cannot agree upon such conditions and compensation within sixty days following service of the Commission's order requiring such agreement, the Commission shall, within sixty days thereafter, establish such conditions and compensation. Such compensation shall be limited to costs incurred plus a reasonable profit.

(c) (2) Cancellation of any reciprocal switching agreement, or obstruction of any prospective reciprocal switching agreement, the purpose or effect of which is to eliminate or to prevent alternate competitive rail service, is prohibited. Exaction of compensation for switching service in excess of costs incurred plus a reasonable profit shall be deemed constructive cancellation or obstruction and is prohibited. Any rail carrier, shipper, receiver or other party directly impacted by such cancellation or obstruction shall have the right to a permanent injunction against such cancellation or obstruction upon application to any district court of the United States in the area where such agreement is operative, or has been operative, or would be operative.

Use of Terminal Facilities

Section 7. Subtitle IV, Chapter 111, Subchapter 1, title 49, United States Code, Section 11103(a) is amended to read:

(a) Notwithstanding all other provisions of Subtitle IV of this Title, upon petition of any interested rail carrier, shipper, receiver or other party directly impacted, the Interstate Commerce Commission shall require terminal facilities, including mainline tracks, for a reasonable distance outside of a terminal, owned by a rail carrier providing transportation in interstate or foreign commerce, to be used by another rail carrier where necessary to provide alternate competitive rail service by the latter carrier if the Commission finds that use to be practicable without substantially impairing the ability of the rail carrier owning the facilities or entitled to use the facilities to handle its own business. The Commission shall take final action upon such petition no later than ninety days after the filing of such petition with the Commission. The carriers are responsible for establishing the conditions and compensation for the use of the facilities in order to provide such alternate competitive rail service. Such compensation shall be limited to costs incurred plus a reasonable profit. However, if the carriers cannot agree within sixty days following service of the Commission's order requiring such use, the Commission shall, within sixty days thereafter, establish conditions and compensation for use of the facilities. The compensation shall be paid or adequately secured before a carrier may begin to use the facilities of another carrier under this section.

Consolidation, Merger, and Acquisition of Control; General Procedures and Conditions of Approval

Section 8. Subtitle IV, Chapter 113, Subchapter III, title 49, United States Code, Section 11344(c) is amended to read:

(c) The Commission shall approve and authorize a transaction under this section when it finds the transaction is consistent with the public interest. The Commission, where one or more rail carriers are involved, shall impose as a condition of approval of the transaction that such carriers or successors thereof shall not cancel joint rates and/or through routes, or reciprocal switching agreements, or trackage rights agreements, in which such carriers participate, and shall not refuse to participate in prospective joint rates or through routes, or reciprocal switching agreements, or trackage rights agreements, when or where the purpose or effect of such cancellation or such refusal is the substantial lessening of competition between and among railroads, creation of monopoly, or restraint of trade in railroad freight transportation. The Commission may impose other conditions governing the transaction. When the transaction contemplates a guaranty or assumption of payment of dividends or of fixed-charges or will result in an increase of total fixed charges, the Commission may approve and authorize the transaction only if it finds the guaranty, assumption or increase is consistent with the public interest. When a rail carrier, or a person controlled by or affiliated with a rail carrier, is an applicant and the transaction involves a motor carrier, the Commission may approve and authorize the transaction only if it finds that the transaction is consistent with the public interest, will enable the rail carrier to use motor carrier transportation to public advantage in its operation, and will not unreasonably restrain competition. When a rail carrier is involved in the transaction, the Commission may require inclusion of other rail carriers located in the area involved in the transaction if they apply for inclusion and the Commission finds their inclusion to be consistent with the public interest.

Application

Section 9. Subtitle IV, Chapter 117, title 49, United States Code is amended by adding a new Section 11712 to read:

The provisions of sections 1 through 9 of this Act shall apply to current or future railroad actions and to those occurring or consummated prior to the enactment of these provisions, including those involving transportation in intrastate, interstate or foreign commerce which may otherwise have been exempted from regulation under subtitle IV of title 49, United States Code.

APPENDIX C

PROCOMPETITIVE RAIL STEERING COMMITTEE

Section-by-Section Summary of Legislative Proposal

Introduction

When Congress enacted the Staggers Rail Act of 1980 it carefully balanced the interests of the railroads and the interests of the shipping public. The greater discretion accorded the railroads was in large part based upon the mandatory expectation that carrier competition, i.e., competition among and between the railroads themselves, would not only be preserved but would be strengthened. Such inter-railroad competition would ensure more efficient and more economical service for the shipping public.

However, as the Staggers Rail Act has been administered by the Interstate Commerce Commission, this objective of the Congress is not only not being achieved, it is being frustrated.

It is the belief of the Procompetitive Rail Steering Committee that clarifying legislation is necessary. It should be emphasized that this involves limited, additional action by the Congress to achieve the increased inter-railroad competition Congress originally had in mind in enacting the Staggers Rail Act.

The Procompetitive Rail Steering Committee's proposals are embodied in seven sections. A summary of the various proposals follows.

Section 1

This section designates the legislative proposal as the Railroad Competition Act of 1984.

Section 2

This section describes the proposal's purpose, which is to promote and strengthen competition between and among the nation's railroads in order fully to implement the present congressional railroad transportation policy.

Section 3

This section contains clarifying language directed to ensuring effective competition among rail carriers as well as between rail carriers and other modes.

Section 4

This section prohibits cancellation of through routes and/or joint rates where the purpose or effect of such actions is substantially to lessen competition, create a monopoly, or restrain trade. It permits aggrieved parties to obtain a permanent injunction from U.S. District Court against such railroad action, including rescission of any prohibited cancellation already in effect.

Section 5

This section is directed to enhancing inter-railroad competition, to achieve the objectives of the congressional rail transportation policy. Where a railroad provides service under a single line rate, or a joint line rate, on a particular category of traffic between a given origin and destination that railroad shall, upon request of another railroad having an actual or practicable interchange connection with the first railroad between the same origin and destination to do one of two things. It shall either participate in at least one competitive joint rail rate via that interchange on that traffic with that connecting rail carrier between the same points or it shall publish a competitive proportional rate on the traffic to or from that interchange point. This requirement shall apply at each actual or practicable interchange connection location. In addition to the carrier requesting the joint rate and through route any shipper or receiver desiring competitive rail service between the origin and destination also has standing to request and obtain comparable relief under the same conditions.

Section 6

This section makes mandatory rather than permissive the reciprocal switching provision contained in the Interstate Commerce Act where such agreements are practicable and in the public interest, or where necessary to provide alternate competitive rail service. This section also establishes time limits within which such agreements must be implemented. It prohibits cancellation of such agreements where the purpose is to eliminate competition or prevent alternate competitive rail service. Aggrieved parties have the right to obtain a permanent injunction against the cancellation or other obstruction from the U.S. District Court in the area in which the agreement has been, or would be, operative.

Section 7

This section makes mandatory the use of terminal facilities, including main line tracks for a reasonable distance beyond terminal areas, by carriers seeking to provide alternate competitive rail service if the ICC finds such use can be accomplished without impairing the ability of the rail carrier owning, or entitled to use, the facilities to handle its own business.

Section 8

This section requires that the Commission shall impose as a condition of approval of railroad merger applications that the carriers or their successors shall not cancel joint rates and/or through routes, or reciprocal switching agreements, or trackage rights agreements, in which they participate and they shall not refuse to participate in prospective joint rates or through routes, or reciprocal switching agreements, or trackage rights agreements, when or where the purpose or effect of such cancellation or refusal is the substantial lessening of competition between and among railroads, the creation of monopoly, or restraint of trade in railroad freight transportation.

Section 9

This section mandates that provisions of this legislative proposal apply to current or future railroad actions and retroactively to those occuring or consummated prior to the enactment of these provisions, including any segment of transportation which may otherwise have been exempted from regulation by the Interstate Commerce Commission under existing provisions of the Interstate Commerce Act.

Senator PACKWOOD. Thank you, sir.

Mr. Gastler.

Mr. GASTLER. Mr. Chairman, subcommittee members, my name is Harold Gastler. I am president of the MKT Railroad, more commonly known as the Katy. I am appearing here today on behalf of the Katy and other members of a group called RAM, or Railroads Against Monopoly. I do not represent that group that is 1000-percent win on the other side of that record. We are a small group of regional railroads that are united in an effort to correct abuses we have encountered since the origin of Staggers Act which we were for, but we have found the interpretation of Staggers to be very unfortunately against us.

Those railroads, by name, are—and they are mostly represented here today—the B&LE, Central Vermont, DW&P, EJ&E, FEC, Grand Trunk Western, GB&W—and Mr. Selby, president of the GBW, was introduced—the P&LE and the Katy.

I have a letter that I will leave for the record here from the president of the P&LE who could not be here. I would like that entered in the record, please.

Senator PACKWOOD. Without objection.

Mr. GASTLER. I certainly want to thank the subcommittee for letting me appear today on the part of these regional railroads and talk about a real problem we have in operating in our business. The problem basically is the real indiscriminate cancellation of joint rates and routes by the large railroads, and then the resultant failure of the ICC to at least give us some attention on these cancellations and maintain competitive routes.

Just to give you an example, most of Katy's competitors and many of Katy's customers are far larger than we are. They have the opportunity for multiple sourcing, and when you talk about contracts, multiple sourcing is very important both from origin-destination and product standpoint. This becomes quite a problem for a small regional carrier.

Contrary to what the AAR has said, and we are members of that, the problem is very real. We do not think the recent NIT League-AAR proposal corrects that problem. We have suffered massive cancellation of joint rates.

Now, we were not opposed to the cancellation of rates that were not being used and had become impractical, but in the effort of—in canceling these rates, we did not see any fine tuning of the cancellations. Market power simply canceled these rates in a meat-ax approach. They are all gone.

We then have the problem of going back and trying to restore rates to, let's say, our own customers in the Oklahoma-Texas area, for something as simple as lumber. We are unable to serve our own customers.

Slowly this is being resolved, but if you go back to the Commission and attempt to prove an antitrust case, and go through the courts to get the solution, you can be broke by the time you get the various appeals over and done and back, and in fact, none of them have been resolved at this time, and Staggers is fairly old in its duration.

We survive, the railroads I represent survive on the economic well-being of our customers. That is what causes us to survive. We see that we keep our customers competitive. That is our business. We think that maybe the NIT League and AAR tried to correct this, but we see the solution as nothing more than continued unfettered discrimination by the ICC in the interpretation of the Staggers Act. That has not worked for us now. There are no standards for these decisions, and we propose that something must be done. As reluctant as we are to ask for some reregulation, we are forced to do that.

We think some solution—and we plan to offer a bill which will do that. We hope to process that through in the upcoming year. We have not been able to satisfy our problems in any other manner, and we will be trying to move forward to correct our problems as a small railroad and to correct the problems of small industries that we serve.

We are sorry to have to ask you for a congressional solution. We do not think the ICC has interpreted the intent of the Congress, of the conference, but we will be back.

We certainly thank you very much for being able to appear today.

[The statement follows:]

STATEMENT OF HAROLD L. GASTLER, IN BEHALF OF KATY RAILROAD AND RAILROADS AGAINST MONOPOLY

My name is Harold L. Gastler and I am President and Chief Operating Officer of the Missouri-Kansas-Texas Railroad Company, often referred to as the Katy. I am appearing here today on behalf of Railroads Against Monopoly (RAM), a coalition of regional and smaller railroads which have united in an effort to remedy some of the abuses which have arisen since the passage of the Staggers Rail Act of 1980 (Staggers Act). The member of RAM are Bessemer and Lake Erie Railroad, Central Vermont Railway, Duluth, Winnipeg & Pacific Railway, Elgin, Joliet and Eastern Railway, Florida East Coast Railway Company, Grand Trunk Western Railroad, Green Bay and Western Railroad, Pittsburgh and Lake Erie Railroad, and Katy.

My testimony will provide the Subcommittee with some specific examples of Staggers Act abuses suffered by Katy. These abuses are in the form of (1) cancellations of efficient joint rates in which we previously participated and (2) refusals of our large connections to join with us in proposed new joint rates. Each of the members of RAM can recite similar abuses at the hands of their large connections. In fact, all of us have presented these examples and others to the Interstate Commerce Commission (Commission) in several different forums. The problem is that the Commission has done nothing to rectify the situation and. by its latest action in Ex Parte No. 445 (Sub-No. 1), has put the matter in a posture where regional railroads can expect no solutions in the near future.

In that proceeding the Commission has adopted a set of rules agreed upon between the large railroad members of the Association of American Railroads (AAR) and the National Industrial Traffic League (NITL). These same large railroads are, of course, those whose actions give rise to a need for some remedy in the first place. The RAM group presented the Commission with a set of rule which would have solved the problem but these rules were totally unacceptable to the AAR. The RAM railroads pointed out to the Commission and now to this Committee that the AAR/NITL rules adopted by the Commission will not correct the abuses which have caused the immense number of parties to complain and call for redress.

In the Commission proceeding, Conrail representatives called the Commission action a political compromise designed to forestall legislative action and that is precisely how we would characterize it. I would add that it will be a travesty of justice if such an obviously discredited and ineffective rule results in postponing a real solution to the joint rate and route problem.

The remainder of my testimony discusses some of the legislative history of the Staggers Act concerning jointrates and routes and will show that Congressional intent is not being followed by the Commission. I will also point out:

That the Commission has concluded that the Staggers Act provision dealing with joint rate cancellations—is rarely employed and is of little significance;

Some examples of the large carriers' actions which are most damaging to the right to small railroads to compete for joint line traffic;

How several Circuit Courts have criticized the Commission for its failure to adequately consider the interest of regional railroads;

The fallacy of the theoretical economic argument on which the large railroads' actions are based; and

How some large railroad themselves contradict their own espoused economic theories when faced with the prospect of joint rate cancellations by newly merged carriers.

Finally, I will outline for the Committee the solution the RAM group proposes in draft legislation. That proposed legislation is being made available to the Committee and its staff at this time.

The Staggers Act grew out of a proposal of the Carter Administration in 1979 which was embodied in S. 796 introduced by Senator Cannon on March 27, 1979 and H.R. 4570 introduced by Congressman Staggers on June 21, 1979. The act that was passed was the result of extended debate among interested parties both inside and outside of the rail industry. Many solutions were proposed to the problem of how to revitalize the railroads. Gradually, consensus developed that less government regulation should free the carriers to make economic and financial decisions like other businesses. This, in turn, would generate revenues to modernize equipment and roadbeds and provide the opportunity for profitable operations.

A major issue, and certainly one which delayed passage of the Staggers Act for many months, was how much regulatory freedom the railroads should be given in the ratemaking areas. There was general agreement that the then-current system was antiquated and needed to be replaced. However, there was much disagreement among the carriers on the proposal to grant railroads the unilateral right to cancel joint rates. Many of the RAM members, together with numerous other small railroads throughout the United States, opposed any provisions which would permit such cancellations. As I will explain below, this opposition was based upon a fear that the larger railroads would cancel joint rates wherever it was possible to carry the freight on their longer, single line movements.

S. 796 and H.R. 4570 would have totally eliminated the Commission's authority to prescribe joint rates. At hearings during 1979, this approach was the subject of intense opposition from a broad group of witnesses. Later versions of the deregulation bill (S. 1946 and H.R. 7235) introduced after the 1979 hearings rejected the total deregulation proposal for cancellation of joint rates. The Senate bill, S. 1946, had no provision to deregulate joint rates and the House bill, H.R. 7235, provided for a limited deregulation of joint rates.

The outcome of that struggle was a compromise which permitted the cancellation of a joint rate if the canceling carrier was not receiving revenues equal to at least 110% of its variable costs from the joint rate. Alternatively, if the canceling carrier was receiving less than 110% of its variable costs on a competing line, cancellation of the joint rate was not permitted if it received revenues equal to at least that same ratio under the joint rate. The rationale behind this legislative solution was that a large railroad should not be permitted to cancel a joint rate merely because it wanted to haul the traffic exclusively over its own lines. Rather, the Congress wanted to facilitate cancellations of *unprofitable* joint rates, and its set 110% as the standard.

It is clear that the Staggers Act conferees intended the enactment of 49 U.S.C. 10705a as the means for correcting the joint rate problems brought to the attention of Congress. The conference report (H.R. Rep. 96-1430, pages 111-112) explains this as follows:

"Two of the major problems caused by the existing joint rate system are too low rate divisions and a proliferation of uneconomic routes protected by the archaic 'commercial closing' doctrine."

"The conferees intend that the conference substitute will alleviate these problems in part by assuring that the carrier, with a minimum of regulatory interference, will be able, by applying surcharges or directly conceling routes, to either earn revenues over all lines equal to or exceeding 110 percent of unadjusted ICC formula variable cost or to close routes not providing this level of earnings . . . ." (page 111)

During the period when the Staggers Act was under consideration, much of the discussion centered on the need to make joint rates profitable and efficient and to eliminate those which were not. Conrail was the chief promoter of this amendment. At that time its Chairman and Chief Executive Officer Edward G. Jordan complained that "Conrail today carries substantial freight tonnage at rates that are non-compensatory"[1] and stated further that "Conrail, for example, is even unable to raise rates which are below variable costs."[2] In responding to a question by Chairman Florio, Mr. Jordan emphasized the problem for which a solution was sought by referring to the revenue/cost ratio table in his testimony as follows:

"Take a look at the figures from sough to east, 95.7 on long term variable cost. Do you want to go on running the railroad losing money? That is what we are trying to solve."

In further discussing the joint rate problem during the course of that hearing, Mr. Jordan testified that Conrail had been seeking a compromise ". . . which would solve the problem of what we believe to be the non-compensatory traffic particularly in the northeast, although I would add there are other railroads who feel they are losing money."

This then was the problem with which Congress was confronted and section 10705a now in Title 49 of the United States Code was enacted in specific response to that problem. It provides a specific limited and special provision for surcharges and cancellations of joint rates when they are unprofitable.

The Commission, however, has not paid any attention to 49 U.S.C. 10705a and has adopted a policy which has essentially nullified the remedy adopted by Congress. In its reply brief to the United States Supreme Court on petition for writ of certiorari the Commission explained that:

"Since 1979, however, the Commission has abandoned its former policy of suspending tariffs that cancelled joint rates and now routinely allows such tariffs to go into effect. Accordingly, section 10705(e) now controls the vast majority of joint rate cancellations. As a result, section 10705a—and with it the Lee Amendment—is rarely employed and of little significance." Reply Brief for the ICC, page 3 (April 1985); *ICC v. BRAE Corporation*, No. 84-550.

The Commission thus has effectively ignored the remedy provided by the Congress, "abandoned its former policy" with respect to cancellation of joint rates, and "now routinely allows such tariffs to go into effect." In effect, the Commission has told the Congress that it doesn't care about the Congressional remedy and that it will carry out its own policy through a reinterpretation of the old law which routinely allows cancellations that the Congress expressed specific concern about during consideration of the Staggers Act.

On at least four occasions Federal Courts of Appeals have reversed and remanded Commission decisions for failure to adequately consider various factors of the public interest in its implementation of the Staggers Act. It is important to note that what these courts have consistently said is that the Commission is not giving consideration to important elements of the statutory protections that are provided. The effect of the Commission's cavalier approach is to rubber stamp the anticompetitive actions of the large carriers in eliminating competition from smaller carriers that otherwise would be available through utilization of joint rates. The Courts have not looked favorably on the Commission's approach.

In *Chesapeake & Ohio Railway Company v. United States*, 704 F.2d 373 (7th Cir. 1983), the action of the Commission in approving Conrail's cancellation of a large number of joint rates at one time was vacated and remanded. After observing that ". . . there is no competitive or other dimension of the public interest at risk in this case besides the interest in not closing a more efficient route in favor of a less efficient one," the Court held:

"Because of the deficiencies in Conrail's study, which provided the essential factual basis for the Commission's decision approving the joint rate cancellations, the decision must be set aside as unsupported by substantial evidence." 704 F.2d at p. 379.

In reaching this conclusion the Court said: "if a large fraction of the Conrail cancellations (one-half, in our example) in fact reduced rather than increased efficiency, the Commission was not acting in the public interest in approving them all; and nothing in the record before us excludes the possibility that just such a meat axe approach was taken." Id.

In *Green Bay & W RR v. United States*, 644 F.2d 1217, 1229 (7th Cir. 1981), the Court overturned another of Conrail's joint rate cancellations, stating that although the "Commission relied heavily on efficiency considerations in approving the rate cancellation," the evidence was hardly conclusive on that issue. In *Detroit, Toledo & Ironton R. Co. v. United States*, 725 F.2d 4750 (6th Cir. 1984) dealing with merger protective conditions (so-called DT&I conditions), the Court reversed and remanded the Commission observing that its decision is fatally flawed "because of its total failure to consider, as required by Congress, the effect of its ruling on regional rail competition."

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[1] Testimony of E. G. Jordan, Chairman and C.E.O., Conrail before the Subcommittee on Transportation and Communications of the House Committee on Interstate and Foreign Commerce, Oct. 16, 1979, p. 389.

[2] Id., p. 399.

Finally, in *BRAE Corp. v. United States*, 740 F.2d 1023 (D.C. Cir. 1984), *cert. denied* (1985) the D.C. Court of Appeals criticized the Commission's approach to the joint rate question by repeatedly stressing the Commission's "failure" to "fully consider" or "adequately explain" various aspects of joint rate cancellations.

The clear and persistent point of all of these reversals is that the Commission simply has not been giving adequate attention to what the Congress provided as guidelines for solving problems related to joint rates and joint rate cancellations. Even though the courts have uniformly criticized the Commission for its lack of attention to legislative intent, the Commission has not in any significant way thus far changed its attitudes or holdings. The failure to modify its policy seems to reflect an attitude of disregard for Congressionally mandated remedies.

Because of the many problems associated with cancellations of joint rates, related competitive access issues and the likelihood of Congressional action, the Commission instituted a proceeding in Ex Parte No. 456 to consider the problems. During that proceeding the AAR persuaded the NITL and the Chemical Manufacturers Association (CMA) to agree to a set of rules which would purportedly solve the joint rate and route problem. These rules, along with an alternative set of rules proposed by the RAM group of regional railroads, were considered by the Commission in a subsequent proceeding designated Ex Parte No. 445 (Sub-No. 1). A special open voting conference has been held in that proceeding after the record was closed and the Commission has made it known that it will adopt the rules proposed by AAR/NITL/CMA without substantial change.

The problem with the rules to be adopted is that the rules provide little or no relief from the anticompetitive joint rate and route cancellations that have occurred and will occur in the future. RAM, the group that has been most harmed by the Commission's administration of the joint rate cancellation provisions of the act, has described the Commission's agreed upon rules as being of little or no value. The AAR proposed rules have no workable, specific standard and leave total discretion to the Commission. We believe that the Commission should not have total discretion because it has failed to protect the public interest with regard to joint rate and route cancellations. The major intent of such rules is to achieve Conrail's expressed goal of having a "political solution" that would take the pressure off the Congress in considering remedial legislation.

Although all our RAM members except one are also members of AAR, the AAR does not represent us on this issue. Now that railroad mergers have resulted in six large rail systems controlling AAR policies, the AAR appears unconcerned about joint rate cancellations. In comments filed with the Commission in Ex Parte No. 445 (Sub-No. 1), AAR quotes the Commission with approval for the proposition that the rate and route cancellations that have occurred since enactment of the Staggers Act were what Congress expected, and that there is no reason to conclude that such actions are generally contrary to the competitive policies of the Staggers Act or unreasonable per se. (AAR Comments, p. 11). The AAR was not of this view, however, when the Staggers Act was under consideration. Testifying before the Subcommittee on Surface Transportation of the Senate Committee on Commerce, Science and Transportation, AAR President Dempsey discussed the administration's proposal to deregulate joint rates as follows:

"One of the problems, but only one of them, I would point to by way of illustration . . . is the kind of case in which one railroad is a partner in a through route—a joint rate arrangement with another between two points—and has a single line route between those same two points. If that carrier has the unlimited right to cancel the joint rate and establish his own local rate, he could exercise that power in such a fashion as to drive all traffic to his single line route. That, we think, would be an abuse of monopoly power . . . ."[3]

We are at a loss to explain the change in AAR's position except for the fact that the large rail carriers are the ones engaging in the very action opposed by AAR in the hearings considering passage of the Staggers Act.

The large railroads, and Conrail particularly, repeatedly claim that they have not cancelled any efficient joint rates but only inefficient joint rates. The record discloses this to be inconsistent with the facts. In this regard see the discussion of the *Chesapeake & Ohio* case, supra, where the court noted that efficient rates and inefficient rates had both been cancelled. In fact, the real purpose of the cancellations is to increase revenue for the cancelling carrier regardless of the efficiency of the remaining routes.

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[3] Hearings, May 22, 1979, pages 301-302.

The most uniformly practiced abuse of this concept is the one by which large carriers issue cancellations of all joint rates in which they participate between origin and destination points that the cancelling railroad itself serves in single line service. These actions are taken summarily without regard to whether some joint line routes between those origin and destination points may be more efficient or less efficient than the remaining single line route. Unquestionably, there are many joint route movements which are more efficient than single line movements. But the point here is that the railroad makes no pretense of having examined the facts to determine which joint line movements being cancelled may be efficient and which may be inefficient. What makes matters even worse is that many of the joint routes cancelled by the large carriers were being used by shippers served by the smaller carriers. The result is that smaller carriers no longer have routes from and to the shippers physically located on their tracks and cannot participate in traffic generated by those shippers.

At this point I would like to give some specific examples of the kinds of anticompetitive joint rate cancellations to which I refer and to which we object. My examples will be limited to those in which the Katy has been adversely affected. However, as I mentioned earlier, each of the members of the RAM group has furnished similar examples in great detail to the Commission in the various proceedings which have dealt with this problem. The Katy provided details with respect to activities of the Southern Pacific Transportation Company (SP) and The Atchison, Topeka and Santa Fe Railway Company (SF) in canceling joint rates with Katy in their merger proceeding before the Commission. If the Committee is interested, I would be happy to furnish copies of that extensive testimony but for the purpose of this statement I will briefly summarize some of the actions to which I refer.

Beginning in December 1982, the SP published a series of route cancellations cutting off all lumber routings where the SP published rates to a destination in territory served by Katy. Prior to these cancellations, the SP and the Katy had lumber routes from the Kansas City Gateway to Dallas/Fort Worth, Texas, Houstion, Texas, and generally to other Texas points. SP route closings in 1983 applied on commodities generally from west coast points to SP/St. Louis Southwestern Railway Company (SSW) destinations. Again in January 1983, the SP restricted its Texas intrastate routings to SP/SSW routes.

In April 1983, the SP/SSW System cancelled routes with Katy for Canadian Lumber, forcing traffic which moves via the Kansas City Gateway to move circuitously from Kansas City to St. Louis, or even El Paso, Texas, before coming back to Texas destinations.

All of these actions were across-the-board cancellations of our routes whether or not they were more efficient than the SP/SSW routes that were preferred and kept in effect by such actions. The Canadian Lumber Rate cancellations provide the most glaring example of the kinds of inefficient actions that are taken by the large railroads. By that action the SP forced Kansas City to Dallas traffic to move SP/SSW direct via St. Louis or via El Paso instead of moving via the previously used Katy/SP joint route. The joint line mileage via Katy/SP from Kansas City to Dallas is 506.2 miles, while the SSW/SP single line route via St. Louis is more than twice as long. When forced to move over the SSW/SP route via El Paso, as some of it was, the mileage is more than tripled. Traffic from Kansas City moving to Houston when forced to move via St. Louis by the SP's action adds at least 271 miles to the journey than when moving by the previously used Katy/SP route. For San Antonio at least 522 miles are added. It takes a vivid imagination to even argue that such circuitous movements are more efficient than the routes with the Katy to such destinations, and in the face of this it is difficult for me to understand how the large railroads can continue to assert that they only cancel inefficient joint rates.

Other examples are from 1984 SF route closing publications. The first of these restricted the routing to SF only, whenever the SF serves an origin and destination or if it serves routings from or to gateways. This is a standard action taken by virtually all the big railroads and of course has no relation to efficiency or inefficiency. It is a simple exercise of market power, the effect of which is to require that shippers use SF single line routes regardless of whether they are efficient and regardless of whether the shipper may prefer a more efficient joint line service.

The second type of action taken by the SF was to publish route cancellations which contain a special exception providing that they do not apply to the SP or to the SSW, SF's potential merger partners. The evidence submitted by our witness in the SF/SP merger case shows a number of examples where these cancellations resulted in forcing traffic to move over circuitious mileage. Obviously the effect of such sweeping route cancellations is not to improve service to shippers but to enhance the canceling carrier's revenue.

Subsequently, the SF also exempted the Union Pacific and Burlington Northern from its route closures. The net effect of these actions is that SF now maintains joint routes with the other larger western railroads, apparently because of internal route agreements between the larger carriers, but SF does not maintain joint routes with the smaller regional carriers such as Katy and Kansas City Southern Lines. What is even more onerous is that between many origin-destination sets, the SF-Katy joint route would be the shortest of all routes.

The other primary means used by large railroads to eliminate competition by railroads like Katy, which necessarily must rely upon joint rates, is the refusal of large railroad connections to enter into new routes and rates with carriers like ours. The evidence we submitted in the SF/SP merger proceeding lists scores of examples of refusals by both SP or SF to enter into new routes and rates pursuant to which the Katy could compete for traffic.

The question must be asked: Do the route cancellations by larger railroads which leave only one single line route available to the shipping public promote competition as intended by Congress in the Staggers Act, or would competition be enhanced by having additional joint line routes available to compete with the larger carriers single line route? I believe the answer is obvious and you will agree that maintenance of several routes would greatly promote competition and be in conformity with Congressional intent in the Staggers Act and be in the best interest of the shipping public.

The theories put forward by the large railroads' economists say that a large railroad would have no incentive to cancel joint rates that are efficient nor would it have any incentive to refuse to join in a new joint rate that is efficient. The examples cited above totally discredit these theories. The fact is that the canceling railroads have and are engaged in a program which some of them describe as "revenue enhancement." [4] These programs enhance the canceling carrier's revenues by closing joint routes and placing restrictions upon its participation in joint line movements with other carriers where the joint line route competes with its favored single line route.

These actions are quite satisfactory and justifiable from the large railroads' view when small railroads are the victims. However, when a large rail system faces similar cancellations, the story is quite different. For example, in presenting its views on the proposed acquisition of Conrail by Norfork Southern, the CSX Corporation indicated that Conrail's 1981 "massive route cancellation program," had "disregarded service efficiencies." The CSX document goes on to state that:

"A combined NS-CR system similarly can be expected to attempt to force rail traffic to move entirely on its line in every instance where the merged carriers are capable of providing single system rail service. Also, wherever the merged carrier is the only rail carrier available to handle the origin service, a combined NS-CR system will attempt to impose routing restrictions that would require the rail traffic to move on the longest available NS-CR system wide haul.

"The end result could be to deprive rail shippers, throughout the vast area to be served by the combined NS-CR system, of any meaningful competition for their rail movements. Only those rail shippers opened to competitive rail service at both the origin and destination points of their movements can be sure to avoid the grip of the NS-CR combination." (CSX statement, p. 68).

This is a straightforward description of what happens in the real world of joint rate activities among railroads. But AAR and its two economists (in justifying actions against small carriers) proclaim a different story and recite the proposition that large railroads would not cancel efficient rates or routes because they would have no incentive to do so. The CSX statement, however, makes clear its view of whether the alleged lack of incentive would be an effective restraint in the following terms:

"A combined NS-CR system cannot be expected to curtail interline competition by cancelling routes only where such routes afford more circuitous and less efficient service than the new NS-CR single line service. Instead, it can be anticipated that the NS-CR system will foreclose interline service with other rail carriers wherever through service on the NS-CR system is available, even if the interline service is more direct or otherwise more efficient. Because the cost of running any major rail system is largely non-variable, the combined NS-CR will have a built-in incentive to avoid interlining traffic with other carriers wherever possible and to increase its share of 'joint line revenues wherever interlining occurs.' " (CSX statement, pp. 69-70).

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[4] Counsel's Exhibit: MKT-C-6, filed in ICC Finance Docket No. 30400 for a compilation of memoranda prepared by SP during 1983 describing SP's "Revenue Enhancement Program."

The RAM group offered a set of specific rules to the Commission in Ex Parte No. 445 (Sub-No. 1). Shipper groups, including the NITL and CMA were solidly behind the concepts proposed by the RAM rules in the early stages of Ex Parte No. 456. Because of the hardline attitude taken primarily by Conrail and followed by the AAR in flatly rejecting any such proposal that included a specific test such as the revenue to variable cost test, NITL joined with the AAR in the proposal that will soon become the Commission's rules dealing with competitive access. As I have stated, we do not believe those rules will be effective or useful in curing the problem. The legislative bill that I am submitting to the Subcommittee with my testimony today is, I believe, absolutely necessary if the problem of joint route and rate cancellations is to be solved. It is based upon the same fundamental specific revenue to variable cost tests that were embodied in the RAM rules so bitterly opposed by the large railroads. That revenue to variable cost test is the same kind of test adopted by Congress in the Staggers Act in several provisions dealing with the reasonableness of rates as well as the cancellation and surcharging of joint rates. It is not a new concept for Congress and, indeed, it is a test that already has been approved by Congress and placed in statutory terms. That test is the overriding principle of our draft bill.

Not only does it have precedent as a statutory provision, it has also been strongly endorsed by the noted economist Dr. William B. Tye of Putnam, Hayes & Bartlett Inc., Cambridge, Massachusetts. After pointing out the weaknesses and inequities in the AAR/NITL rules, which he aptly described as the "do nothing" or "permissive" approach, Dr. Tye concludes that:

"The RAM proposals are ingeniously designed to place the cost of any relative inefficiency squarely on the shoulders of the carrier whose route or service is the less efficient. As a result the RAM proposals actually create strong incentives for the participating carriers and shippers as well to avoid inefficient routing practices and for carriers to engage in meaningful competition for the traffic. The RAM proposal not only permits price and service competition (which would be precluded entirely by the permissive approach): it explicitly provides a role for price and service competition to encourage efficient routing of traffic." Direct testimony in verified statement of Dr. William B. Tye, May 31, 1985 in Ex Parte No. 445 (Sub-No. 1) Intramodal Rail Competition.

Dr. Tye further concludes in his reply verified statement filed on July 8, 1985 in the same proceeding that:

"RAM's revenue/variable cost tests would keep competitive access open, allow price and service competition to work on even terms, and create strong incentives for efficiency by making every carrier that chose to offer a service bear the cost of any relative inefficiencies that would result. This is exactly what should happen under competition." (p. 2).

The draft bill proposed by the RAM group is based upon the same ratio of revenue to variable cost test which was the heart of the RAM proposed rules in Ex Parte No. 445 (Sub-No. 1) to which Dr. Tye was speaking.

The RAM bill provides procedures and criteria for determining when the Commission should suspend the cancellation of joint rates. Under the Commission's implementation of existing law there is no suspension—not one cancellation has been suspended since 1980. Under our bill there would be five grounds for suspension. Three of these are for failure to meet certain procedural requirements such as adequate notice, failure to provide data necessary for testing a cancellation, and failing to meet for the purpose of negotiation within ten days of a request. The fourth test for suspension is the revenue to variable cost test which simply means that the cancellation will be suspended if the canceling carrier's percentage of profit over the proportion of the rate or route proposed to be cancelled is not lower than its percentage of profit over a competing route. The fifth test is to provide for cancellation if the cancelled route is shorter than or substantially equivalent to the distance via any competing rate or route in which the carrier proposing the cancellation continues to participate. The bill then provides that, upon investigation, the proposed cancellation will not be permitted if the same revenue to variable cost and mileage tests used for determining whether suspension should be granted are present.

The final provision of the bill addresses the problem where large railroads refuse to concur in competitive joint rates proposed by regional carriers, such as the members of RAM. Where the proposed rate provides the non-concurring carrier with the revenue to variable cost ratio thast is equal to or greater than the lowest revenue to variable cost ratio it receives for its portion of any competing rate or through route, the Commission shall order the non-concurring carrier to concur.

About the only worthwhile result of the Commission's time-consuming efforts in Ex Parte Nos. 456 and 445 (Sub-No. 1) is the recognition by the Commission, the AAR and others that a real problem exists with respect (1) to competitive access, (2) to the cancellation of joint rates, and (3) to the refusal to join into newly proposed joint rates. Unfortunately, having recognized the existence of a problem the Commission is adopting rules that will not provide a solution to the problem. We believe that a Congressional solution, base on RAM's Draft Bill is the only solution possible. We urge the Committee to seriously consider the Commission's failures in this regard and move forward with a legislative solution with teeth, and we offer the RAM Draft Bill for that purpose.

Senator **Packwood**. Thank you, sir.

Mr. Bush.

Mr. **Bush**. Thank you, Mr. Chairman. My name is George Bush, and I am the general manager, traffic, of LTV Steel Co. in Cleveland, OH. LTV is the Nation's second largest steel producer and is a substantial user of and is heavily dependent on low cost rail transportation, which I attempted to quantify in my written statement.

I appreciate the opportunity to comment briefly on our experience with Staggers and with particular emphasis on the issue of competitive access.

Our experience with the Staggers Rail Act is not unlike that of many other companies. It works great when competition exists. In the absence of rail competition, shippers are vulnerable, exploitable and dependent on the ICC for protection. There is widespread dissatisfaction with the manner in which the ICC implements the Staggers Rail Act, particularly with regard to competitive access. Strong intramodal rail competition is what makes Staggers work. Companies struggling to survive in the steel business understand competition and also understand that rail competition is essential to survival and growth.

Wholesale joint rate and route cancellations by the railroads, coupled with ICC indifference, has given rise to proposals for remedial legislation. There is a competitive access problem, and I believe railroads have become increasingly aware of shipper dissatisfaction. Consequently, members of the Association of American Railroads and the National Industrial Transportation League began discussions on how to resolve the problem. Those discussions were held under the auspices of the Presidential Advisory Committee of the NIT League. That committee is comprised of members of both organizations. In other words, there are railroads involved and shippers of all sizes and shapes.

After a year of difficult and protracted negotiation, an agreement on competitive access was reached in January 1985. The Presidential Advisory Committee proved to be an excellent forum for the resolution of this complex problem. As chairman of that committee, I participated in the deliberations and was impressed by the efforts of many dedicated people to achieve agreement. This process of negotiation is in keeping with the efforts of the ICC to get shippers and carriers to negotiate rather than litigate. It is also consistent with the Senate Joint Resolution 331 introduced by Senator Danforth.

The ICC, I understand, has just recently adopted the AAR-NIT League agreement, and it is the position of my company that the proposed legislative changes with respect to competitive access are premature at this time, and that the joint NIT League-AAR agreement, however imperfect, be given a chance to work.

The competitive access issue is of extreme importance to my company. If the AAR-NIT League agreement does not work or the ICC fails to properly implement, we will most assuredly join the throng clamoring for remedial legislation.

In our view, it would be tragic to abandon the agreement without even giving it a chance. Moreover, if this method of negotiation succeeds on the competitive access issue, it might well succeed in resolving disputes on other controversial issues.

Thank you.

[The statement follows:]

STATEMENT OF GEORGE C. BUSH, GENERAL MANAGER—TRAFFIC, LTV STEEL CO.

My name is George C. Bush. I am General Manager-Traffic, of LTV Steel Company. My address is P.O. Box 6778, Cleveland, Ohio 44101.

LTV Steel is the nation's second largest steel producer. LTV Steel ships approximately ten million tons of product to the Trade per year. A substantial part of this traffic moves by rail. It takes about three tons of raw material such as iron ore, coal and limestone to make one ton of finished product and these materials move principally by rail. In addition, LTV also ships annually about 5.6 million tons of semifinished steel products and other materials such as coke between its various facilities. These interplant transfers are predominantly moved by rail. Thus, it can be seen that LTV Steel is a large user of and is dependent on rail transportation service. Some LTV facilities are captive to one railroad.

I am grateful for the opportunity to express our views on our experience under the Staggers Rail Act with particular focus on the issue of competitive access. Where competition exists the Staggers Rail Act works to the benefit of shippers and carriers. Where competition does not exist shippers rely on the protection of the Interstate Commerce Commission (ICC). Manifestly, there is widespread dissatistfaction throughout the shipping community with the manner in which the ICC implements the Staggers Rail Act, particularly on the subject of railroad competitive access. The contemporary view seems to be that the ICC is indifferent to the problems of the captive shipper and, therefore, cannot be looked to for protection. In short, shippers dependent on rail services are vulnerable and exploitable.

Competition is what makes the Staggers Rail Act work. Our industry and our company has come to understand competiton as we struggle for our very existence in an environment of fierce domestic and foreign competition. Intramodal rail competition is essential to the survival and growth of the steel industry and our company. Rail transportation is such a large segment of our overall cost that we simply cannot tolerate an environment that produces non-competitive rail transportation service.

The public concern over the competitive access issue has given rise to proposed remedial legislation. There appears to be little doubt that a problem exists. Wholesale joint rate and route cancellations by the railroads created a furor and the ICC was not responsive to shippers protests. Railroads have a growing awareness of shippers discontent.

As a consequence, members of the Association of American Railroads (AAR) and the National Industrial Transportation League (NITL) began a series of discussions to see if there was some method of resolving the competitive access problem without resorting to litigation or legislation. Discussions were held under the auspices of the League's Presidential Advisory Committee comprised of NITL members and members of the AAR. The purpose of the Presidential Advisory Committee of the League is to identify long term business related issues affecting transportation and to develop and recommend policy positions which will enable shippers and railroads to implement programs addressing their concerns. Competitive access was an ideal topic to discuss in this forum.

The discussions between AAR and NITL continued for over a year and culminated in an agreement between the two groups on January 23, 1985. As chairman of the Presidential Advisory Committee I participated in these final deliberations. The negotiations between AAR and NITL were vigorous, intensive and protracted. With both sides modifying their positions again and again until agreement was finally reached. Neither side was completely satisfied, and the final agreement was in every sense of the word a truce compromise.

The agreement provides for guidelines to be followed on the competitive access issues. These guidelines were submitted to the ICC in *Ex Parte No. 445 (Sub No. 1—Intramodal Rail Competition)* and jointly recommended by NITL and the AAR.

On its own motion the ICC initiated *Ex Parte No 456, The Staggers Rail Act of 1980—Conference of Interested Parties*, for the purpose of exploring ways and means of more effectivley implementing The Staggers Rail Act. Competitive access was one of the issues and the joint AAR/NITL agreement was submitted in that proceeding as a recommended method of addressing the problem. Other groups such as the Chemical Manufactures Association and Chlorine Institute suggested modifications.

The joint AAR/NITL agreement, as modified, is presently before the ICC In Ex Parte No. 445 (Sub. No. 1). In an open Special Conference held September 11, 1985, the ICC orally adopted the agreement. We are awaiting the final decision on the findings, conclusions and discussion of the issues.

The guidelines provided in the AAR/NITL agreement may be imperfect, but they are fair and reasonable in our opinion and should be given an opportunity to work before major legislative changes of the SRA or the antitrtust laws are considered.

Having been a participant in the negotiations between the AAR and NITL I was impressed with the efforts of a great many people to resolve differences on this complex issue. There was an honest desire to reach agreement. The League's Presidential Advisory Committee provides an excellent forum for dialog between the railroads and broad based shipper interests on controversial subjects. It is this kind of arrangement that the ICC is promoting in Ex Parte No. 456 and is consistent with Senate Joint Resolution 331 introduced by Senator Danforth.

It is the position of LTV Steel that proposed legislative changes with respect to competitive access are premature at this time and the AAR/NITL guidelines should be given a chance to work. Competitive access and the encouragement of railroad intramodal competition are key issues with our company and if we find the guidelines in the AAR/NITL agreement inadequate or if the ICC fails to implement them vigorosuly and properly we will be the first at your door pounding for remedial legislation.

We think it would be tragic to abandon the AAR/NITL agreement at this time in favor of a legislative approach without ever putting it to a test. Moreover, if the agreement does work it would strengthen the resolve to work out other differences by negotiation rather than through legislation or litigation.

Thank you for the opportunity to present our views.

Senator PACKWOOD. Thank you, sir.

Senator Long.

Senator LONG. Mr. Petruccelli, now, this is an impressive group of industries that you speak for here, your procompetitive rail steering committee. I take it that you support the provisions of S. 477 that have to do with competitive access.

Mr. PETRUCCELLI. That is correct, sir.

Senator LONG. Now, I am impressed by your statement here, and I think it deserves a great deal of thought from the committee.

Let me ask you if you consider the further amendments to S. 477 proposed by Senator Andrews and others, and anything else in that bill that would create problems for members of your group?

Mr. PETRUCCELLI. As I stated in my testimony, the procompetitive group has concentrated its efforts specifically on the competitive access issues. And therefore, we have taken no position for or against any other aspects of any legislation. We think that the competitive issue is the one that will resolve our problems.

I have not seen the latest revised proposal of the CURE bill, so I could not comment on it, but at this point in time, the procompetitive committee has no position one way or the other on the other sections of that bill, sir.

Senator LONG. Are you in a position to point anything out in that bill that your group would be compelled to oppose?

Mr. **Petruccelli**. No, sir. At this point there is nothing that we have decided to either oppose or support.

Senator **Long**. Well, I am impressed by your statement, Mr. Petruccelli, because to a large extent it is voicing exactly the same concern and documenting what those of us who introduced that bill are concerned about—or in the main it certainly does, and I hope very much that we can act along the lines that you are advocating.

Of course, I do hope that you will study the further amendments that have been suggested by Senator Andrews—I am a cosponsor—and see if you can support the bill in general as we would propose to amend it, because we are trying to solve the problem you are addressing.

Mr. **Petruccelli**. We certainly will study it, sir, when we see it.

Senator **Long**. Let me say to you, Mr. Gastler, that I think you would help your case if you would document it by something that people who do not understand the railroad business as well as you do would understand. I think you need a few charts so that someone can look at them and you can explain that here is where our line is, and here are customers A, B, and C. Here is what happened, and here is what the answer ought to be, so that we could look at it.

I can understand what you are talking about, but I had a course in college about the economics of rail transportation. Just for the benefit of the people out there who are not as well educated as you or I, I would think that it would help if you would give us a few charts, a few diagrams to graphically illustrate that problem.

Could you do that for us?

Mr. **Gastler**. I would be delighted to do it, and can, yes, yes. We certainly can.[1]

Senator **Long**. I am satisfied that you have a problem. I have talked with other railroads who are not among the very large ones, and there is no doubt that they have a problem. Mainly what you are talking about, I take it, is that you need more, that the act has in many instances knocked out joint rates.

Mr. **Gastler**. Right.

Senator **Long**. And with that, if we are not careful, we will put your customers out of business. If we put your customers out of business, you are out of business.

Mr. **Gastler**. That is right, and of course, we see—we thought—we favored Staggers. We thought it would be procompetitive, and it has been except that our large railroad friends have knocked us out of joint routes. Now our customers cannot get service, and eventually we think this will lead to the demise of the regional railroad.

Now, some of our large friends do not mind that, but we are here to say that if you do not have swapping ability, and basically it is swapping ability between like two large carriers will agree to keep routes open because they both have many multiple sources, multiple origins and destinations. We do not have that. They do not swap with us. So our routes remain closed. But we can certainly illustrate the point by some graphs or some charts which will show the real problem.

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[1] The charts were not reproducible and are in the Committee files.

We have had no success appearing before the Interstate Commerce Commission with our problems. We continue to have those, and we are reluctant to seek relief here, but you represent our only option.

Senator **LONG**. Thank you.

Senator **PACKWOOD**. Gentlemen, I have no questions. Thank you very much.

The hearing is adjourned.

[Whereupon, at 12:20 p.m., the committee recessed subject to the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF HON. TONEY ANAYA, GOVERNOR, STATE OF NEW MEXICO

Mr. Chairman and Members of the Subcommittee, I am Toney Anaya, Governor of the State of New Mexico. I thank you for this opportunity to express my support of Senate Bill 477, the Consumer Rail Equity Act, which is designed to enhance rail competition and to ensure reasonable rail rates where there is an absence of effective competition.

As you are aware, with the passage of the 1980 Staggers Rail Act, rail shipping of bulk commodities was deregulated in the United States. The intent of the Staggers Act was to let competition determine rail rates where a competitive market was present, and to continue regulatory oversight by the Interstate Commerce Commission where no competition existed. This deregulation measure has essentially been very beneficial to the rail system and was responsible for restoring most of the ailing railroads to financial health. However, the captive shipper provisions of the Act have not been so successful in addressing the concerns of western mineral, agricultural, and certain bulk commodity shipper interests. As a result, some of the shippers by paying higher rail rates have shouldered in my opinion a disproportionate share of the costs of operating and maintaining America's rail system.

Coal production is one of the West's most active areas of resource development and thereby has allowed us to claim new markets for electric energy production in the West, with substantial penetration also being achieved into electric utility markets in the Midwestern and Gulf States areas.

One major impediment for increasing our share of coal markets, with the associated increased production of western coal, is the high cost of transportation. Western coal, unlike its eastern and midwestern competitors, has no practical alternative to rail transportation. Many western mines, including a large segment of New Mexico producers, have no practical alternative to rail transportation. Our mines are far removed from many of our markets, a situation which renders trucking economically unfeasible and water media coal slurry pipelines impracticable (because of water shortages in the arid west); river/barge alternatives do not exist. Therefore, producers and shippers of not only coal but also other bulk commodities are captive to relatively few, large rail systems in New Mexico. Within the coal community alone, many coal producers and consumers believe they have suffered negative economical impacts because of the railroads' tendency to charge higher rates in cases where no other rail or alternative mode of transportation now exists.

The National Governors' Association clearly expressed their positions relative to the captive shipper issue at our past summer meeting in Boise, Idaho. The Governors agreed that the Nation's rail freight system continues to be of key importance to the transportation of coal. Pursuant to The Staggers Rail Act of 1980, Congress recognized the unique dependence of coal shippers on rail transportation and the importance of balancing the needs of rail carriers, coal shippers, and the public. The Governors supported the basic principles of deregulation embodied in the Staggers Act.

However, the Governors are extremely concerned about the way in which the Interstate Commerce Commission (ICC) has been implementing provisions of the law, thereby placing an unfair burden on captive coal shippers, consumers of electricity, and consumers of coal. Areas of specific concern to the Governors were as follows:

Under the Staggers Act, rates for shipments are deregulated unless the ICC determines that a particular shipment is captive or a carrier has market dominance in transporting goods. The ICC in its regulations does not consider a shipment as captive or a rail carrier as having market dominance if geographic, modal, or product substitutions are available. The Governors are troubled by this overly restrictive interpretation of the law and believe that the application of this theoretical standard to coal and agricultural suppliers is unfair and inappropriate. With regard to product substitution, the negative effect on shippers and consumers of coal is particularly severe because an electric utility plant could be required to convert to other energy sources at prohibitive costs. The Governors urged the ICC to take action to redefine captive shipments in its regulations to make clear that a rail shipment is captive unless an economically alternate means of transportation is available. Should the ICC fail to act by January 1, 1986, the Governors supported Congressional action to ensure full protection for captive coal and agricultural shippers.

The proposed rate guidelines for coal shipments subject to ICC review do not give equitable consideration to all parties involved. An example of ICC inaction is the experience of the Arizona Electric Power Cooperative (AEPCO) in their efforts to achieve reasonable coal hauling rates between the New Mexico Mentmore Coal Mine and their electrical generating station at Cochise, Arizona. This testimony was given to your subcommittee by Mr. Flanders on November 4, 1985. It is interesting to note that since August 1977 AEPCO rates have increased from $5.80 per ton to $15.83 per ton by 1985, a 273% hike. After the many years in which AEPCO has complained to the Commission they remain uncomprehending as to how the Commission can justify such pricing as consistent with the balance between shipper and carrier interests struck by Congress in the 1980 Staggers Act. AEPCO is now back before the Commission once again. Yet these guidelines may also be extended to other bulk commodities.

The Governors urged the ICC to further revise the guidelines to balance the needs of carriers, captive shippers, and the public. The Governors also recommended that the Congress in reviewing the Staggers Act make certain that an adequate balance exists between the needs of shippers and the railroads' need for an adequate rate of return.

The Governors believe the failure of the ICC to properly define captive shipments and equitably implement the coal rate guidelines mars the otherwise sound implement of the Staggers Act. Action by the ICC is considered necessary to rectify this situation. However, the Governors opposed changes to the Staggers Act in areas other than those addressed in the above cited policy.

I do not personally believe that the captive shippers problems will ever be solved by the ICC. The ICC track record to this point is partly and correctly stated by the Consumers United For Rail Equity in their April 10, 1985 fact sheet. "Quite simply the ICC has failed to provide captive shippers with any protection against railroad abuses of monopoly power.

The Commission has yet to determine any railroad rate to be unreasonably high under post-Staggers Act Standards, and even some of the Commission's own independent Administrative Law Judges have expressed doubt that it ever will. In nearly every major rulemaking, the Commission has adopted the railroads' proposals."

I earnestly urge Congressional consideration in the enactment of S.477, the Consumer Rail Equity Act. This proposed legislation would change the Staggers Act to alleviate many of the problems which have plagued captive shippers since its passage in 1980. I believe that significant and necessary changes are contained in the proposed legislation. One of these major changes clarifies that market dominance would be presumed if only one railroad is serving the same origination and destination point for a single commodity. Another vital issue addressed by S.477 is in the determination of rate reasonableness. The burden would be shifted to the railroad to prove that a proposed rate is reasonable. Other provisions of S. 477 which should prove beneficial include the standards and procedures for detemining revenue adequacy in that the ICC must also consider all relevant financial information in its determination of revenue adequacy.

Again, I strongly urge the subcommittee to support S.477 in order to assure a more balanced approach to railroad-shipper relationships and restoration of the equilibrium contemplated in the original Staggers Act. I appreciate this opportunity to submit my remarks into the Senate record.

STATEMENT OF HON. MARK WHITE, GOVERNOR, STATE OF TEXAS

The Staggers Rail Act of 1980 was Congress' endorsement of the need for a more competitive rail industry. In regions of the country where competition existed or is developing, everyone's a winner: the shipper, the carrier, and the consumer. However, there are too many instances where shippers have no reasonable competition and neither Staggers nor the ICC is protecting them. For this and other reasons I will describe, I am endorsing S. 477, the Consumer Rail Equity Act of 1985. I consider this legislation a necessary call to protect shippers and consumers subject to railroad monopoly power.

In the State of Texas, coal shipments were once virtually 100 percent captive, with 86 percent of the 25.4 million tons of coal coming into the state in 1983 controlled by a single railroad. I call that a monopoly. During that same year, railroad transportation charges represented approximately 60 percent of the price of coal delivered to electric utilities in the state.

In 1985, I am happy to say that is changing. In March, I was able to announce a contract between Utility Fuels Inc. and Burlington Northern-Atchison Topeka and Santa Fe Railroads that would transport coal from the Powder River Basin at a savings to Houston Lighting and Power customers of more than $60 million a year for each of the next 15 years. Later that month, a 20-year contract between Chicago and North Western and the City Public Service Board of San Antonio was signed that dropped the transportation price of coal from $27.66 per ton to $20.06 per ton, a reduction of almost 30 percent. Since 1983, rail transportation rates involving coal shipment to Texas have dropped by $131 million annually. This is equivalent to cutting 13 percent of Texas' total annual bill for Western coal. With our long history of attempts to secure rate relief, why are we suddenly so successful? The answer is competition the willingness of a rail carrier to reach into the highly profitable geographic domain of another and to allow the marketplace to determine prices.

An opportunity for captive shippers to seek more competitive rates is created by the Consumer Rail Equity Act of 1985. It amends the Interstate Commerce Act to change the ICC's present discretionary authority in several important areas: competitive access, market dominance, revenue adequacy test, and rate reasonableness.

The ICC continues to plead for more time to implement Staggers, a responsibility they have now had for five years. Recent ICC decisions continue to emphasize the need for Congressional action. As an example, the new Coal Rate Guidelines—which continue to rely on stand-alone cost as the primary measure of permissible rail rates—offer little hope for captive shippers. As expensive as it is to build new rail lines, it is ludicrous to base rates on the cost to a captive shipper of building its own line to get its commodities to their destination.

I have long been an advocate for a national transportation system that meets and balances the needs and interest of rail carriers, their users, and the public. As Attorney General, I was involved in deliberations that led to enactment of the Staggers Rail Act of 1980. As Governor, I also have fought to amend federal laws to provide for more competitive rail transportation.

At the 1983 annual meeting of the Southern Governors' Association in Austin, Texas, the governors participated in a live teleconference with a dozen leading European coal buyers who assembled at the Port of Rotterdam. These representatives of utilities and industries throughout Europe, who are traditional purchasers of Southern coal, expressed strong criticism of rapid increases in rail rates following the passage of the Staggers Act.

Following the teleconference, the governors adopted a policy position which I sponsored that called upon the ICC to revise its regulations with regard to captive shippers and, failing such action, for the Congress to act to protect captive shippers.

At the 1984 annual meeting of the Southern Governors' Association, the governors reaffirmed their support of the previously adopted position on rail rate deregulation, and adopted an additional policy position which I offered relating to U.S. coal exports. This policy position spoke directly to the concerns of producers regarding the need for increased competition, both between modes of transportation and firms within a specific mode, while supporting the overall goals of the Staggers Act.

Today more than ever, it is clear that only legislation can preserve the benefits of competitive access for all and give captive shippers a fair chance to challenge unreasonable rail rates at the ICC, something the Staggers Act tried, but was unable to do. I have also endorsed S. 447, the Railroad Antimonopoly Act of 1985, with its efforts to clarify the current confusion over the railroad's inclusion or exemption from antitrust law. Either or both legislative approaches would improve the captive shippers' access to competition.

STATEMENT OF THE AMERICAN BAKERS ASSOCIATION

The American Bakers Association ("ABA") appreciates the opportunity to submit this statement of its views in connection with the hearings called by this Subcommittee to examine the implementation of the Staggers Rail Act, as carried out by the Interstate Commerce Commission ("ICC") since 1980.

ABA is a nationwide organization of over 300 bakers and baking companies operating nearly 1,000 plants in 49 states. ABA's members produce and distribute over 80% of the bread and baked products consumed annually in the United States.

Flour, the major bakery ingredient in terms of both volume and cost, generates the greatest single inbound cost for bakers and is the principal product moved by bakers over the lines of the Nation's railroads. Conservatively estimated, the annual rail freight bill paid by ABA members exceeds $200 million, with transportation charges making up over 33% of the cost of baked goods to consumers. Shipments are made both on an "F.O.B. Destination, Freight Prepaid" basis, with transport costs rolled into the price paid by the baker for the flour, and on an "F.O.B. Origin, Freight Collect" basis, with the baker making (and paying for) its own transportation arrangements directly.

ABA supported the rail regulatory goals envisioned by Congress in 1980, and endorsed the view expressed in the Staggers Act that competition—rather than regulation—offers shippers the best method by which to protect themselves from railroad pricing and service abuse. ABA continues to subscribe to this concept; however, the ICC's performance in administering the Act has left a great deal to be desired in fulfilling Congress' original intent.

Since 1980, the combination of rail mergers and a pattern of behavior by the larger carriers aimed at reducing, rather than expanding, effective transportation competition has bred an environment of increased captivity on the part of volume commodity shippers. Moreover, this reduction in competition has taken place during a period of excess rail capacity, indicating the even greater power these carriers will have over shippers as volumes increase again and the margin of available rail equipment and facilities narrows.

In the face of a business trend toward greater market concentration, shippers must turn to the ICC for protection. Under the Interstate Commerce Act as amended by the Staggers Act, the ICC possesses the power—and the duty—to intercede to prevent expansion of the captive shipper community, by intercepting anticompetitive carrier practices and enhancing new opportunities for transportation alternatives. If competition fails, the ICC's mandate is to monitor rates and service practices on captive traffic and use its regulatory authority to ensure their reasonableness.

The ICC, however, thus far has turned its back on shippers. Pursuing a "hands off" policy which increases the power and wealth of a few large carriers at the expense of their smaller competitors and the shipping public, the ICC has given the major railroads carte blanche to employ tactics to restrain or eliminate competition, then, having created newly captive customers, exploit the failed market through exhorbitant rates and unreasonable service demands. Neither of these results was intended or foreseen by Congress in 1980, but they nonetheless have occurred. There is, unfortunately, no alternative but for Congress to intercede once again.

THE ICC'S FAILURE TO PREVENT REDUCTIONS IN COMPETITION

It is not easy to start a railroad. The magnitude of investment required effectively separates the rail industry from other businesses, where start-up costs allow reasonably easy entry into a market by new participants when a lack of competition is apparent. It is therefore doubly important that action be taken before the fact to prevent reductions in rail competition before they occur, as well as to assist where possible new competitive options as they appear. That such a role was envisioned for the ICC by Congress was confirmed in 1983 by then Subcommittee Chairman (now full Committee Chairman) Senator John Danforth. Speaking in Kansas City he said:

"If fewer rail carriers are available, then shippers must retain access to as many railroads as possible through joint agreements and reciprocal switching. Congress intended for shippers to have adequate economic leverage. If the benefits of joint routes, joint rates and reciprocal switching are lost, Congress may have to intervene."

* * * * * * *

"I think it is important that the ICC recognize that deregulation is only a tool to be used in shaping a more economical, efficient, responsive transportation industry. It is not something that should be pursued only for its own sake."

When the Stagger Act was being debated, many railroads initially opposed the bill out of fear that their revenues could be harmed by "cut-throat" competition. This fear, in turn, was born out of the Act's expansion of the ICC's power to promote and enhance competition—particularly competition between railroads—and the carriers' belief that the ICC would be making aggressive use of this power. Once it became apparent, however, that the ICC was not inclined to use its power in the manner and to the extent intended, the railroads took full advantage of the ICC's inaction to pursue a variety of anticompetitive strategies.

For example, in 1982 Conrail—with the ICC's blessing—abruptly cancelled hundreds of single-factor joint rates with other carriers, and placed a number of onerous restrictions on its participation in others. The most common result of this action, undertaken without warning or economic justification, was to force many shippers into using single-line Conrail service on movements which previously had enjoyed the benefits of competitive alternatives presented by the joint-line routes. Similar effects have been felt as a result of the cancellation or modification of pre-existing reciprocal switching arrangements among competing carriers, and the unilateral imposition of unreasonable increases in switching charges.

These and other anticompetitive practices have tended to emphasize the "separateness" of each of the Nation's rail systems. Rather than fostering an integrated rail system disciplined my competition and innovation, the actions of the large carriers since 1980 have served to Balkanize the system, creating separate fiefdoms within which each carrier is left free to exploit captive shippers and smaller rail lines.

When called upon to stop or remedy the effects of these practices, the ICC has either stood by mute or, worse, actually encouraged them, contrary to the clear public interest standards of 49 U.S.C. §§ 10705 and 11103. For example, in two cases—*Universal Forest Products* v. *Seaboard Coast Line Railroad* and *Central States Enterprises* v. *Seaboard Coast Line Railroad*—the Commission went out of its way to find reasons to overturn initial decisions ordering reciprocal switching. In each case, the administrative law judge or review board below had made sound findings of fact as to each element of Section 11103(c), only to be overruled on vague "policy" grounds by the full Commission. The result in each case left shippers subject to increased market power in the hands of individual carriers.

More subtle—but equally threatening—work was seen in the 1984 decision in *Continential Grain Company—Petition for Declaratory Order*. There, the ICC ruled that a line-haul rail carrier can force a smaller switching carrier to use the line-haul carrier's cars whenever they are available for service. This constituted a reversal of a two-year old policy permitting the switching carrier to use its own cars, and opened the door for disruption of existing switching arrangements as switching carriers—threatened with the loss of per diem payments—seek increases in or cancellation of switching tariffs. Again, the result is greater freedom for the larger carriers to reduce competition and increase the shippers' exposure to higher transportation rates.

The ICC claims to have "resolved" problems of competitive access for shippers through the rules recently adopted in *Ex Parte No. 445 (Sub-No. 1)*. These rules are designed to handle disputes arising under those provisions of the Act dealing with joint rates and through routes and reciprocal switching arrangements. While they may be a modest improvement over the status quo, however, the rules do not go nearly far enough in restoring balance and objectivity to the process to obviate the need for legislative intervention.

While the new "competitive access" rules tinker somewhat with the notice requirements and evidentiary guidelines incident to efforts by rail carriers to cancel joint rates or close through routes, they fall well short of the mark in terms of providing firm protections for shippers. For example, the guidelines permit suspension or investigation of a proposed cancellation only where the cancellation would eliminate rail competition. In a five railroad market, for instance, the rules would allow the systematic elimination of all effective competitors, so long as one weak firm was left. Additionally, the rules give the ICC a multitude of reasons for refusing to stop a cancellation, and no firm guidelines on how to evaluate a challenge in the context of these standards. Instead, the focus is entirely on the cancellation's effect on railroads—the shipper effectively is ignored. The outcome of an evidentiary stalemate is thus clear: the challenger loses. Moreover, the *Ex Parte No. 445 (Sub-No. 1)* rules offer little in the way of an expansion of the ICC's exercise of its authority to order reciprocal switching, and say absolutely nothing on the subject of terminal trackage rights, an inportant element of the ICC's power under Section 11103 insofar as shippers are concerned.

With regard to the initiation of new competition or aggressive action to prevent the foreclosure of existing competition, the ICC is prepared to continue to accept "business as usual" with no meaningful changes. As even the few examples outlined above make clear, however, meaningful changes are necessary to restore vigor to the provisions of law put in place by Congress to preserve and enhance intramodal competition. The price of inaction is a marked increase in the size of the captive shipper community.

THE ICC'S FAILURE TO PROTECT CAPTIVE SHIPPERS

The ICC's abdication of its duty to vigilantly monitor rail carrier practices to protect existing competition is only half of the story. At the same time that the agency has been idle in enforcing safeguards against anticompetitive rate cancellations and route closings, it has presided over an erosion of those protections enacted by Congress to insulate captive shippers from the imposition of unreasonable rates. ABA is especially concerned about this trend as well, since the steady reduction in rail competition permitted by the ICC since 1980 forces shippers to place increased reliance on the regulatory structure to protect their interests.

Briefly noted below are the major deficiencies in the ICC's approach to regulation under the Staggers Act which, in ABA's view, pose the greatest threat to captive shipper interests and call out most loudly for remedial action by Congress. In conjunction with each, ABA offers a summary of the legislative response which would be most appropriate.

1. *Railroad Revenue Adequacy*

The Problem: The ICC's methodology for measuring the revenue adequacy of a rail carrier ignores all indicators of financial health except one: whether the carrier is earning a return on its net investment equal to the current cost of capital. Moreover, the "investment base" defined by the ICC includes inflated tax and debt service expenses, unused and non-useful assets, and overvalued property accounts. As a result, every Class I rail carrier is deemed to be "revenue inadequate," in spite of the fact that many are engaged in expensive, internally-funded acquisitions and diversifications, and are touted as sound long-term investments by financial analysts.

The Solution: Legislation should be enacted to amend the revenue adequacy provision of the Interstate Commerce Act (49 U.S.C. § 10704) to prohibit the ICC from relying on any single indicator of financial health in determining revenue adequacy, and require that the ICC, in measuring carrier rates of return, accurately calculate the railroad investment base, e.g., using actual instead of current debt costs, excluding deferred taxes, and writing down or off unused or non-useful assets. The approach embodied in S. 477, the Consumer Rail Equity Act, is a sound one.

2. *Standards for Rail Rates*

The Problem: In measuring maximum reasonable rates under 49 U.S.C. § 10701a—particularly in connection with movements of captive bulk commodities—the ICC has elevated revenue adequacy to the principal, if not sole, goal to be achieved. Additionally, the ICC has effectively nullified the captive shipper protections built into the Act by the Long-Cannon Amendment by imposing impossible burdens of proof and data production on shippers and refusing to consider the Amendment's criteria unless the burden is met.

The Solution: Legislation should be enacted which, at a minimum, clarifies that revenue adequacy is but one (not the only) consideration in establishing maximum reasonable rates, places the burden of producing evidence responsive to the Long-Cannon criteria on the parties possessing the data (i.e., the railroads), requires the ICC to make specific findings as to each of the Long-Cannon criteria in every case where the reasonableness of a rail rate is called into question, and requires that the ICC consider, among other factors, evidence of the relationship of the challenged rate to the cost of providing the service, the impact of the rate on national energy goals, and whether the traffic involved in being required to pay an unreasonable share of the rail carrier's fixed costs. The approach to maximum rate reasonableness embodied in S. 477 represents a good blueprint for appropriate legislative action in this area.

3. *Rail Market Dominance*

The Problem: The ICC, with the blessing of one court of appeals, has interpreted the jurisdictional concept of "market dominance" in a fashion which requires shippers and carriers to submit voluminous evidence of the existence of potential, indirect product and geographic competition, in addition to the direct transportation competition which was the focus of Congress' concern. The result has been to turn what was intended as a threshold jurisdictional determination into a complex, antitrust-type proceeding under a set of nebulous guidelines which are unpredictable and effectively preclude the "practical determination without administrative delay" envisioned by Congress.

The Solution: Legislation should be enacted which formally codifies the reforms approved by the ICC in its *Ex Parte No. 320 (Sub-No. 3)* proceeding. Leaving the continuing viability of these reforms in the hands of the agency perpetuates uncertainty in the long-term ability of captive shippers to obtain an adjudication of the reasonableness of their rates.

4. The Rail Cost Adjustment Factor

The Problem: The ICC has established a mechanism to increase rail rates to account for changes in the railroads' cost of providing service which totally ignores the effect of improvements in railroad productivity and fails to require rate decreases when corresponding service costs decline. As a result, the Rail Cost Adjustment Factor used to measure automatic increases overstates the actual effects of inflation on rail costs, and permits a hidden accumulation of profits under the guise of cost recovery during periods of disinflation.

The Solution: Legislation should be enacted to require that the ICC utilize a mechanism for cost recovery rate adjustments that reflects changes in railroad productivity and implements reductions in rail tariffs rates when actual rail costs decline.

5. Exemptions

The Problem: In the Staggers Act, Congress gave the ICC increased authority to grant exemptions in those cases where continued regulation was not necessary to promote national rail transportation policy or protect shippers from abuse of railroad market power. In a number of cases, however, the Commission has attempted to use its exemption authority to free from all regulation transportation which, in many cases, was rail market dominant and therefore in need of continued regulatory protection. While two such decisions have recently been set aside by the courts of appeals, the ICC has shown no inclination to abandon its aggressive exemption program.

The Solution: Legislation should be enacted to prohibit the exemption of a person, class of persons, transaction or service unless a rail carrier is determined, under 49 U.S.C. § 10709, not to have market dominance over the transportation in question.

CONCLUSION

The ICC has shown itself either incapable or unwilling with respect to active enforcement of those provisions of the Interstate Commerce Act designed to preserve and enhance competition where it exists, and offer regulatory protection to captive shippers where it does not. Limited Congressional action is clearly required to restore balance and objectivity to the ICC's arbitration of shipper-carrier disputes, and ensure administration of the Act in a manner faithful to Congress' plainly-stated intent.

ABA supports enactment of S. 447, the Consumer Rail Equity Act, as the most effective means to accomplish these goals. This legislation responds directly to the very real problems outlined in this Statement, without upsetting the basic deregulatory course set by Congress in the Staggers Rail Act.

ABA again expresses its appreciation for this opportunity to share its views with the Subcommittee, and restates its willingness to work with Congress in resolving outstanding railroad rate and service regulation issues in a manner compatible with the equally important interests of shippers, carriers, and the general public.

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION

The American Farm Bureau Federation is the nation's largest general farm organization with a membership exceeding three million families in 48 states and Puerto Rico who are members of 2,762 County Farm Bureaus.

Agriculture, as does the nation as a whole, needs an efficient, sound, healthy railroad system. A railroad freight service policy for the movement of agricultural commodities would not serve the best interests of the farmer, but would also benefit the entire economy.

Farm Bureau recently adopted a railroad policy that rejects the concept of nationalization; recommends that Conrail be returned to the private sector; gives greater ratemaking flexibility to rail carriers to permit more competitive operations, but retains sufficient authority to protect captive shippers against monopoly pricing; eliminates discriminatory railroad rates between geographic areas of the country and opposes parallel mergers of rail systems and the granting of railroad abandonments, which tend to lessen overall transportation competition.

Agriculture has a strong interest in maintaining the long-term efficiency of the railroad system. Railroads are a vital link in the transportation system for agricultural supplies and the marketing of agricultural products. The nation's freight railroads carried 4.8 billion bushels of grain in 1984, making it the second biggest grain hauling year for the rail industry. While railroads are important to agriculture, agriculture is also important to the railroads, because we are one of their best customers.

Farm Bureau supported the enactment of the Staggers Rail Act in 1980 because we believed it carefully balanced the interests of the railroads and the interests of the shipping public and agriculture. The greater discretion in ratemaking accorded the railroads was in large part based upon the expectation that carrier competition, more specifically, competition among and between the railroads themselves, would preserve and strengthen railroad services.

If some form of reduced rail regulation has not been enacted, the bleak financial outlook for railroads would have become even darker in 1980. On July 1, 1980, the Motor Carrier Act of 1980 became law which considerably reduced the ICC's economic regulation of the trucking industry. From 1940 to 1980 the trucking industry expanded rapidly as a result of better hard surfaced roads, better truck technology and the construction of the Interstate Highway System. The expansion of the trucking industry brought about a serious decline in net operating income for the rail industry. In passing the Staggers Rail Act of 1980, Congress concluded that further deregulation of railroads was needed to help them achieve better financial health.

There are indications that the rail industry has endured the current recession better than other industries, and that the Staggers Act will be a tremendous help when rail traffic picks up even more in the years ahead. One example is the success of Conrail which has been profitable for the past two years and is now an attractive investment for private rail operators, as well as other investors.

Although the system under Staggers is fairly new, and because of the recent recession a little too early to observe significant impacts from an agricultural point of view, we believe the system works and that the railroads are once again financially viable and back on the competitive track. The simple fact is that the farmer's products are being moved quicker, better and for the most part cheaper. However, this does not imply there are not some problems with the implementation of Staggers. To a less deregulated environment without some difficulty.

Dissatisfaction among some agricultural shippers has been voiced about as to how the law is being carried out and administered by the Interstate Commerce Commission. Many shippers believe the Staggers Act has not achieved the objective that Congress had hoped for when it passed the Act and that some key modifications are necessary.

CAPTIVE SHIPPERS AND RAIL MARKET DOMINANCE

Prior to the Staggers Act, the ICC was responsible for seeing that rail rates were reasonable and non-discriminatory among a railroad's shippers, among competiting locations served by a railroad, and among competing commodities carried by a railroad. Under the Staggers Act, a railroad may establish any rate it wishes, with the following exceptions:

1. A rate on traffic over which the railroad has market dominance must be reasonable;
2. No rail rate may be below a reasonable minimum; and
3. A rate must not be prohibitive by any specific provision of federal law regulating rail rates.

The ICC's implementation of the Staggers Act has been sharply criticized by some shippers who believe that their traffic is "captive" to railroads because no viable transportation alternative is available at a price they can afford to pay. This idea is also expressed as "rail market dominance."

Farm Bureau favors legislation giving greater ratemaking flexibility to rail carriers to permit more competitive operations. However, we believe sufficient regulatory authority must be retained to protect captive shippers against monopoly pricing. We support the elimination of discriminatory railroad rates between geographic areas of the country. We ask that rates be based on weight, volume and distance on a uniform basis for all regions of the country.

To improve the problem in regard to "captive shipper" and "market dominance," the ICC should develop clear, precise definitions of these terms that recognize the realities of rail transportation. Shippers can seek administrative and judicial protection or relief only with legal standing provided by proper definitions.

JOINT RATES AND THROUGH ROUTES

For many years some railroads, most notably Conrail, argued that they were severely disadvantaged by the portion of revenues they received on traffic shared with other carriers. Rates on interline traffic when billed on a single bill of lading are called "joint rates," and the routes are called "through routes." The Staggers Act has allowed the railroads to increase their revenues on such traffic.

The Act also made it easier for a railroad to stop serving more than one route between two points. Some shippers argue that ICC implementation of these provisions of the Staggers Act, the so-called competitive access, has reduced their transportation options and raised their freight rates. Some railroads argue that they are harmed when one of their interlining rail carriers closes one or more of these routes or raises the joint rate.

An integrated rail transportation system is essential to the efficient movement of agricultural commodities. Grain farmers and shippers need the ability to market their commodities, for both export and domestic purposes, unimpeded by artificial barriers that have been erected by rail carriers. Under the Staggers Rail Act, artificial barriers in the form of canceled rates for through routes do not provide for increased competition in the transportation marketplace. On the contrary, canceled rates for through routes lessen competition by restricting certain carrier participation in specific markets and by limiting the choice a shipper has in getting his commodity to market.

Under the manner in which the ICC is interpreting the Staggers Act, joint rates and routes can be canceled by carriers without opposition from the ICC. This amounts to forced deregulation and restraint of trade by limiting a shipper's access to markets which could be served via a joint route.

Farm Bureau believes there should be some refinement of the Staggers Act to provide reasonable joint rates and switching agreements in order to promote the efficient transportation of commodities among different rail service areas. We believe reciprocal switching should be available at all locations served by more than one carrier at fees based upon the actual cost of performing the service. Railroads should not be allowed to levy arbitrary switching fees that in effect restrict shippers to the use of specific rail lines.

CONTRACTS

Contracts have been generally well received by shippers and the railroads. Both claim that contracts make planning easier, permitting railroads to gauge their investments and provide shippers with more dependable service and prices less subject to change. The major complaint concerning contracts is that not enough information is filed or made available to the public.

Farm Bureau believes that information with respect to rail rates should be made available to the marketplace. The ICC's implementation of the Staggers Rail Act does not permit full disclosure of all economic terms included in rail grain contracts and is contrary to the intent of Staggers. We believe some modification of the Act should be made to provide for the full disclosure of all economic terms of rail grain contracts as Congress intended when it passed the Staggers Rail Act. Improved reporting through full disclosure of contract rates would improve shippers' ability to make intelligent assessments of shipping costs. It would also provide shippers information that is regularly available to them about shipping costs on other modes of transportation.

Farm Bureau has not joined any shipper organization or coalition that seeks to change the Staggers Rail Act. We have tried to identify the justifiable concerns of agricultural shippers without proposing legislative remedies. One of the benefits of reduced regulation is the ability of railroads and their customers to discuss problems and negotiate settlements without the need to reregulate the railroad industry.

We will continue to monitor the Staggers Act and make recommendations, whenever necessary, to resolve the problems that have become apparent over the past four years.

STATEMENT OF THE BOARD OF TRADE OF KANSAS CITY, MISSOURI, INC.

The Board of Trade of Kansas City, Missouri, Inc. (KC Board) also known as the Kansas City Board of Trade is

a. Designated by the Commodity Futures Trading Commission (CFTC) as a contract market for hard winter wheat as well as other futures contracts.

b. A major grain market located at a major milling, elevating, grain processing and rail shipping center where all types of grains are sold.

c. An organization made up of almost 300 business people, a number of whom represent exporters, millers, farmer-owned coops, elevators, merchandisers, brokerage, etc. or all segments of the grain industry. These members are vitally interested in a viable, integrated, national transportation system.

d. An organization with a transportation professional on its staff and with a transportation committee made up of people versed in traffic and who are grain experts. The KC Board has a long history of advocacy before the railroads, ICC, Congress and the Courts for the interest of Midwestern grain shippers.

Since reregulation went into high gear in 1979, the KC Board has opposed many facets of the Railroad Deregulation Act of 1979 (including testimony in Washington on May 22, 1979) as well as opposing similar features in the Staggers Rail Act of 1980 (Public Law 96-448).

One of the features of the Staggers Act we found most oppressive and strongly opposed was Section 208 which now is 49 U.S.C. 10713(a) and provides in part "One or more rail carriers providing transportation subject to the jurisdiction of Interstate Commerce Commission under sub-chapter I of chapter 105 of this title may enter into a contract with one or more purchasers of rail services to provide specified services under specified rates and conditions. Such a rail carrier may not enter into a contract with purchasers of rail service except as provided in this section."

We also opposed other parts of the Staggers Act which dealt with joint rate and route cancellations, reciprocal switching cancellation and rapid tariff changes. All of these were touched on when we appeared in Hutchison, Kansas at the Staggers Act oversight hearings on September 1, 1983. See our testimony printed in Serial No. 98-37 pages 374ff.

This statement will be directed only at the ills of contract rates which we still oppose and maintain should be abolished through repeal of 49 USC 10713 or by an adequate amendment to exclude grain.

The freight rate differentials created by the authorization and use of contract rates has resulted in a destructive competitive practice [1] due to the large disparity that exists between tariff rates and contract rates. Because of the way the law has been interpreted and implemented by the Interstate Commerce Commission (ICC), it is virtually impossible to determine enough terms of a contract to challenge it. Hopefully this may be eased a bit by the pending decision in Ex Parte No. 387 which concerns contract disclosure information. This proceeding has been before the ICC since 1980.

We do not know how many grain contracts have been challenged since 1980 but are aware of two cases when a grain contract was challenged and the contents made known to the parties who challenged the contract. It is our understanding that after disclosure the contracting parties in at least one case mutually canceled the exposed contract and wrote a new one.

With the advent of contract rates large subterminal elevators with their ability to ship larger quantities have been able to enter into favorable contracts as compared to the smaller elevator and affectively draw grain the small elevator usually stored. The smaller elevator may have some idea of the freight advantage due to prices paid for the grain by the large elevator but he can't compete because he does not have the ability to ship large enough quantities to generate comparable freight rates under a contract.

In the 1983 subcommittee hearings held in a number of locations including Hutchison as we mentioned earlier, testimony was submitted to show the ills of contract rates by a number of smaller elevators.

One operator testified that he was handeling 50 percent less grain than two years previously due to the larger elevator operators 80 miles to the west, 110 miles to the northeast and 150 miles to the southeast who had contracts. Their drawing ability to reach out further due to the contract diminished his business significantly. Another operator spoke of investing $75,000 to expand his loading capacity to do 25 cars but was still not able to obtain rates he believed were equitable as compared to that of a nearby house.

We have heard of another case recently where an elevator in Missouri has quit handling rail grain because he could not obtain a contract to be competitive with one another nearby elevator had with a different carrier.

We are certain there are other similar examples like these—they are not isolated examples.

On September 27, 1985 the Union Pacific system published substantially reduced rates on corn, milo and wheat between stations on their lines in the states of Colorado, Kansas, Missouri, Nebraska and Oklahoma to become effective October 18, 1985.

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[1] A destructive competitive practice is a basis for a contract challenge under 49 U.S.C. 10713(d)(B)(ii).

These would have been very beneficial to this market as well as to large and small shippers. Shortly after being published, but before they became effective, the rates were abruptly cancelled.

One of the reasons we heard as to why the rates were withdrawn was because they cut across existing contracts, and were withdrawn at the demand of one of the contract parties.

We would also like to bring to the sub-committee's attention a U.S. Department of Agriculture study made with the cooperation of Kansas State University and titled "Impacts of Rail Deregulation on Marketing of Kansas Wheat" which was issued in September of this year.

Throughout the study mention is made of the impact of contract rates on the small shipper and we specifically refer to the following parts of the study. On page IV of the preface it is stated:

"It is also true that rail deregulation has resulted in economic injury for some shippers, particularly those in country locations attempting to compete with a competitor with a rail contract."

And on page 19 it is stated that:

"Kansas country points are the origins from which the contract/tariff rate comparison is most relevant. Many shippers are undoubtedly still shipping under tariff rates from these points and are attempting to compete with firms having an immediate market advantage of 17¢ per hundredweight due to contracts."

On page 32 under the caption Impacts of Contracts it is stated:

"Information presented in the previous section suggests that single location shippers are under-represented in rail contracting, and that tariff shippers from country locations are at a *substantial competitive disadvantage* with contract shippers from those points." (emphasis added)

Later in the study it is stated on page 32 that:

"In one case where shippers on a branch line reached agreement and proposed a contract that appeared otherwise acceptable to the carrier, the proposal was ultimately refused by the carrier, allegedly because the branch-line contract probably would draw grain now going to elevators on the carrier's mainline. The carrier did not want to compete with its own mainline stations."

In the summary we find on page 35:

"Small single-location shippers generally do not participate directly in rail contracts and the *competitive position of tariff shippers from country locations is threatened* by competitors with a substantial market advantage from contract rates." *(emphasis added)*

Finally, in the conclusion and near the very end it is stated:

"However, it is also true that rail deregulation has resulted in economic injury for some shippers."

The USDA and Kansas State study affirms what we and others have been saying for many years as to the adverse effects of contract rates on the small shipper.

The Kansas City Board of Trade and others have for years contended that there is no place for contract rates on rail movement of grain without hurting the small shipper. Testimonies presented in your 1983 hearings, November 1985 hearings and in the United States Department of Agriculture publication of September 1985 entitled, "Impacts of Rail Deregulation of Marketing of Kansas Wheat" solidly substantiates this fact.

Contract rates on grain should be prohibited or their contents made public by an appropriate amendment to 49 U.S.C. 10713.

We must not forget the Rail Transportation Policies wherein it is stated in 49 U.S.C. 10101a(13) that it is the policy of the United States Government: "to prohibit predatory pricing and practices, to avoid undue concentrations of market power and to prohibit unlawful discrimination;"

We are aware of the accord reached by the Association of American Railroads and the National Grain and Feed Association as to contract rate disclosure but must reserve any comment until we see the wording of the agreement. We are also aware that it will not become effective unless the ICC adopts the agreement which could be part of their decision in Ex Parte 387.

As matters now stand we must stand by our comments set out above.

STATEMENT BY BENNETT LUMBER PRODUCTS/INTERMOUNTAIN WOOD PRODUCTS SHIPPERS ASSOCIATION

My name is Richard G. Bennett. I am Executive Vice President of Bennett Lumber Products, a family owned lumber company that operates 2 mills and employs about 400 people. My family has been in the lumber business for over 40 years. In addition to entering this statement on behalf of Bennett Lumber Products, I am also representing the views of the Intermountain Wood Products Shippers Association, a bargaining cooperative of 24 small lumber companies spread over 4 states, formed in 1984 to negotiate rail rates with the railroads. I serve as President of the Association.

Today, I am an extremely worried man and I know personally a lot of others out there just as worried as I am. People with small to middle-sized lumber companies like mine face many problems, some of them quite complex, that have brought us to the very brink of extinction. The impact of Canadian imports, trade barriers, high interest rates in the lumber industry, to name a few of the problems confronting us, have received a great deal of publicity. One of the least publicized, yet most important threats to small lumber companies like mine however, is the impact of the Staggers Act. For those of us with no economic alternative but that one rail track running by our lumber yards, the Staggers Act has given the railroads the extraordinary power to decide which of us will and which of us will not survive.

In passing the Staggers Act of 1980, providing for deregulation of the railroads generally and the use of private contracts for rail freight transportation, the congress recognized a potential for anticompetitive abuse against small shippers. It attempted to build some protection into the legislation against this happening by including provisions in the Act allowing a shipper that believes itself to be the subject of "unjust discrimination" or a "destructive competitive practice" to seek relief from the Interstate Commerce Commission. The message that I bring on behalf of my company and the companies included in the Intermountain Wood Products Shippers Association is that these protections are simply not working.

Prior to passage of the Staggers Act smaller rail shippers like myself were always kept scrambling to maintain anything approaching parity with our larger, more influential competitors. At the same time, we still had the opportunity to find out what rates and charges our competitors were paying because all rates, charges, rules, and regulations had to be published in tariffs made available to anyone wishing to know them. There were no secret contracts. Having access to this information provided a shipper some protection so that when confronted by discriminatory actions he could always take his complaint before the Interstate Commerce Commission. Now, however, the use of contracts whose terms are agreed to in closed meetings and kept strictly confidential has become a weapon in the hands of the railroads to play one company off against another.

This poisonous business atmosphere is further exacerbated by the fact that thanks again to the Staggers Act, we have nowhere to turn for help. The Interstate Commerce Commission in interpreting the Act has adopted policies that are blatantly pro-railroad and which leave us completely without protection. It is very evident from the Commission's own records that not one out of the more than 800 rate cases brought before the ICC since the Staggers Act was passed has been decided in favor of a shipper. The rules for just gaining access to the terms of a contract a shipper suspects is discriminatory and wishes to challege are so proscriptive that the first challenge was only just brought in February 1985—five years after the Staggers Act was passed. In summary, under the current set of circumstances there is no fairness in the market place and no set of governmental tools with which to restore it.

In order that the Committee might understand better what I am talking about when I say there is no fairness in the market place, the experience of our bargaining cooperative with the Burlington Northern Railroad provides a graphic example.

After the Staggers Act was passed my company began to have trouble with the BN in getting a contract for them to haul our lumber at reasonable rates. By reasonable I mean something at least approaching parity with the larger shippers. We have rarely in the past gotten rates as beneficial as those given larger shippers. Nevertheless, rates at least in the ballpark, within a minimal percentage for similar or same kinds of products shipped from point A to point B seems only fair. Although contracts are confidential, word eventually gets around regarding rates and terms. Not surprisingly we began to hear about contracts given by the BN to larger shippers with far better rates than those offered to us. In talking to other small shippers we found they were hearing the same thing. We did try to challenge a contract under the new rules and quickly found out we would get nowhere at the Interstate Commerce Commission for reasons I will go into later. In fact we were told by legal counsel not to go to the Commission because we would get no help from them. In frustration we began to search for other solutions.

The problem we all had in common was the fact that individually we were small companies in terms of volume and that in conjunction with our captive status put us in a very vulnerable bargaining position with the railroads. It came to our attention that one possible avenue to securing the contracts we sorely needed was to band together and form a shippers cooperative to negotiate with the railroads. The Intermountain Wood Shippers Association was formed with 24 members operating 40 mills with an annual production capability of approximately 1½ billion board feet.

With new found optimism that the substantial volume we now represented would finally allow us to achieve if not rate parity with large producers at least some contracts approaching it, we set out to negotiate. How soon we were rudely awakened! It seems that the railroads while paying lip service to the idea of working with cooperatives in fact preferred not to do so. For months we attempted to work out a fair rate for the cooperative members with the Burlington Northern. The BN first would agree only to an oral contract which past experience with them and common sense made us afraid to trust. Then we managed to negotiate written contracts only to find what was offered in negotiating sessions and what showed up on paper were two very different things. During the whole time we were trying to negotiate with the BN as a cooperative bargaining unit the railroad, in what could best be called a "divide and conquer" tactic, sought to make separate deals with individual members of the cooperative. In a final, what I consider to be entirely agregious act, during negotiations in which I was involved as President representing the cooperative, the BN offered me a separate contract with terms better than what had previously been offered. The only catch was that no similar contract would be offered to the other members. To accept it would have been to sell out the other members of the cooperative I was negotiating on behalf of.

It goes without saying that our optimism degenerated quickly to pessimism about ever being able to bargain with the BN as a cooperative. Beaten and needing to get our products to market, most of the membership made what deals they could with the BN. Some like myself who will ultimately be driven out of business by doing business with the BN have resorted to haphazard methods of getting our lumber to market. Our biggest mill now trucks most of our lumber 60 miles to a Union Pacific line where we get somewhat better rates. I should add that the rates combined with the cost of trucking the lumber aren't better enough to keep our mill running over the long term. This solution is just not economic for that. But it does keep the lumber moving for now.

In any event we have tried everything and are finally left with no choice but to appeal to the Congress for help. In my testimony I mean to discuss two particular areas of concern in which some action by the Congress would go far to restore a climate of economic stability; contract disclosure and private car regulation.

Before beginning, however, I would like it noted for the record that Bennett Lumber Products and the Intermountain Wood Shippers Association consider the issue of competitive access for captive shippers to be of paramount importance. This issue is one that is being aired before the Committee and Congress with great eloquence by others including the Consumers United for Rail Equity and I add my wholehearted support for their efforts. The current market dominance test requiring a shipper to prove it has not transportation alternative and no opportunity to use other products or to obtain the same product another geographical area in order just to seek rate protection from the Interstate Commerce Commission is unfair, impossibly expensive, and unduly burdonsome for a small company to meet. We believe the legislation entitled the Consumer Rail Equity Act, S. 477 as proposed by Senators Andrews, Long, Ford, and Stevens addresses that problem and take this opportunity to urge some action on it by this Committee. Of course we believe the legislation must go further to include some remedy for the other two issues. Nonetheless we wish to make our position of support for it as far as it goes clear.

CONTRACT DISCLOSURE

It is our firm belief that the whole system of contracting for rates between railroads and shippers, at least shippers of agricultural, forest, and paper commodities, needs to be thrown out or something has got to be done about the Interstate Commerce Commission's regulatory procedure for protecting shippers. The very sections put in the Staggers Act to protect captive shippers from discrimination have in the hands of the Commission become a potent force shield protecting the railroad's right to exercise discrimination against us.

First, there is a very limited time frame in which a shipper must act to seek protection from the Interstate Commerce Commission if he suspects he is being discriminated against. Keep in mind that his suspicions are only based on contract summaries that are made public and are nonspecific regarding contracting parties, origins, destinations, and do not list rates. Contracts are filed with the Commission and must be approved or will be deemed approved, unless the Commission has specifically disapproved it, within 60 days after it was filed. After that nothing can be done. Should a shipper suspect a contract to be discriminatory he must file a complaint within 18 days after that contract is filed and the Commission then has until the 30th day after the contract was filed—or 12 more days—to decide whether the complaint justifies investigation of the contract.

Secondly, to bring a case a shipper must prove the railroad is market dominant. This is a nearly impossible feat under current rules. As mentioned earlier, others are adequately addressing this problem and I only bring it up to illustrate the full set of steps necessary to gain a hearing before the Interstate Commerce Commission.

Third, a shipper must demonstrate that he has grounds to bring a complaint. It should be emphasized that these grounds are narrow. The complaining shipper must show that the contract at issue will impair the railroad's common carrier obligation to other shippers. This is an extremely difficult thing to prove since the common carrier obligation to "provide the transportation or service on reasonable request" is minimal. If the complaining shipper is one like myself who ships forest products or agricultural commodities and paper, it must also show two additional grounds for complaint. First, it must show that the railroad has "unreasonably discriminated" by refusing to enter into a contract with the shipper to carry the same commodity on substantially the same terms and conditions as the challenged contract when the shipper was willing and able to agree to those terms. Secondly, the shipper must show that the contract in question constitutes a "destructive competitive practice."

It should be fairly obvious that in order to prove he has grounds for bringing a complaint a shipper must know the essential terms of the contract he is complaining against. Which brings me to the final and most telling obstacle a shipper must overcome to get an audience before the Commission; namely getting a copy of the essential terms of that contract.

The Congress in passing the Staggers Act recognized that to protect against discrimination that could occur in allowing rates to be set through contracts, the essential terms of the contracts would need to be made available. As part of the Act it provided:

"The Commission shall publish special tariff rules for such contracts in order to assure that the essential terms of the contract are available to the general public in tariff format." Section 208(b), 49 U.S.C. § 10713(b).

However, the Interstate Commerce Commission saw matters otherwise and has chosen to heavily favor the confidentiality of contracts in writing rules implementing it. Originally the Commission even required a shipper to show a likelihood of success on the merits of its complaint in order to gain access to the essential terms of the contract. This requirement was challenged in the law courts and found to be "too restrictive." The Commission was directed to rewrite the rules. (*Water Transport Association* v. *ICC*, 722 F.2d 1025 (2d Cir. 1983)). The new rules unfortunately are not much better. The request for the contract must specifically show the competitive injury the complainant believes it will suffer if the contract is approved such as "additional costs, delayed production, and lost markets or market opportunities."

A shipper must show all of this with no knowledge of the essential terms of the contract. It is very much like the children's game of pin the tail on the donkey, but the stakes involved are our business.

In summary, small companies like mine, which do not usually have the advantage of a full traffic department to closely monitor contract summaries and respond to the 18 day deadline on a contract, find ourselves caught in a "Catch-22." The rules were written for the purpose of protecting us but when we appeal for protection under the rules they prohibit us from getting it.

PRIVATE CAR REGULATION

Another problem encountered by Bennett Lumber Products and a number of small companies like ours is discrimination against our boxcars. Again, the source of our problem stems from the Interstate Commerce Commission's intepretation of the Staggers Act.

To provide some background, from the early to mid 1970's the railroads were experiencing a shortage of rail cars. The railroads began trying to convince us to buy our own rail cars which they assured us verbally and in writing they would always take on their tracks. We were told we need not worry about discrimination in terms of rates and the railroads would pay our reasonable operating costs. Purchasing rail cars, particularly the kind needed to haul our high grade, easily damaged lumber products posed an extraordinarily expensive venture and we were hesitant to do so. However, when lumber began to stack up in our yards due to no cars available to haul it and our customers began to complain as well, we went ahead and purchased and leased the more than one hundred cars necessary to meet the demand.

When the Staggers Act was passed private boxcars remained regulated. They were not subject to special pricing schemes that could pave the way to the railroads discriminating against them. Then the Interstate Commerce Commission stepped in and issued a series of regulatory decisions which became known as the Boxcar Decisions. In essence the ICC deregulated boxcars, including private boxcars. This action was challenged in the United States Court of Appeals in *BRAE Corp.* v. *ICC*, No. 83-1462 (D.C.C.A. decided June 27, 1984) and it was held that the Commission had exceeded its authority under the Staggers Act. The Court of Appeals, however, did not issue a writ of mandamus ordering the Commission to proceed under its old rules pending the possibility of an appeal to the U.S. Supreme Court. The net result is that private boxcars are today regulated.

The Burlington Northern, which by now had accumulated a more than adequate supply of boxcars, quickly took advantage of the circumstances and reneged on the earlier assurances it had given us. In July, 1984, BN announced it would accept Bennett private cars on its tracks only if we paid a 25 percent surcharge on top of the usual tariff rates for hauling our products along the BN line. The impact of this BN action was to offset payments made to us by the BN for our 28½ cents per mile operating costs. It certainly more than did that. In fact, agreeing to these terms would have resulted in our losing $500.00 per car each trip and over $35,000.00 per month. One doesn't have to be much of a business person to understand what kind of future incurring losses on that scale would spell out for a company.

Today, our cars stand idle. After months of fruitless negotiations it was and remains clear that the BN had no intention of letting us use our cars once their car shortage problems were solved. Bennett Lumber has now turned in desperation to the law courts for help. There are many other small companies like mine who have been caught in the same dilemma after being pressured earlier by the railroads to buy our own rail cars. We bought those cars in good faith. Now thanks to the Interstate Commerce Commission's tinkering with the Staggers Act, the railroads are taking the opportunity to throw that good faith back in our faces.

CONCLUSION

Fairness in the market place is a critical element in a free enterprise system. Without it we ultimately reach a point where either the general public will clamor for government to step in to protect them or the government will do it of its own volition because order must be restored. We don't want that. Small business is part of the very backbone of the United States. My small company and the others I represent have contributed jobs and income to the economy for nearly half a century. We are not asking for handouts. We are merely asking for fair treatment so we can return to the business of doing business and make our contribution to the national economy. While the Staggers Act was certainly intended to reinvigorate a badly ailing railroad industry, it was just as certain not intended to do it by destroying previously healthy businesses in the process.

Specifically, the Congress needs to legislatively address the captive shipper aspects of the Staggers Act. The interpretation given that section of the law by the Interstate Commerce Commission is clearly not in line with the original intent of the Act. Secondly, the problem of contract disclosure as interpreted by the Commission needs attention. From the perspective of my company and the cooperative members I represent the best approach would be to simply eliminate private contracts altogether and allow for tariffs to be posted for small shippers of agricultural, forest and paper products. This would at least give us a chance to call "foul" when we see it. Finally, it was obviously the intent of the Congress that private rail car traffic remain regulated to avoid the threat of discrimination by the railroads. The Federal Courts concurred. It may well be necessary for the Congress to direct the Commission to reimplement the Staggers Act provisions.

My thanks to the Committee for the opportunity to present our testimony.

STATEMENT OF THE NATIONAL COUNCIL OF FARMER COOPERATIVES

INTEREST OF THE NATIONAL COUNCIL OF FARMER COOPERATIVES

The National Council of Farmer Cooperatives (National Council) is an association of cooperative businesses which are owned and controlled by farmers. Our membership includes 101 major marketing and farm supply cooperatives, the 37 banks of the Farm Credit System, and 33 state councils of farmer cooperatives. The National Council represents about 90 percent of the 6,100 local farmer cooperatives in the nation, with a combined membership of nearly two million farmers.

Cooperatives are in the business of supplying imputs, transporting and marketing commodities for their farmer-owners. Not only does this system carry with it a unique accountability, but is also directly ties the cost of doing business across the food system to the farmer. Cooperatives by definition are non-profit institutions which rebate savings to farmer-owners in the form of patronage refunds. Increased costs of doing business translate into lower savings for farmers.

Farmer cooperatives play a critical role in transporting farm inputs and production. Cooperatives move over 70% of all U.S. milk and milk products, almost 50% of total U.S. grain and soybean production and 25% of the nation's fruits and vegetables. They transport 36% of U.S. fertilizer and lime, and supply about 40% of on-farm fuel requirements.

NCFC SUPPORT FOR S. 477

Cooperative agricultural shippers remain frustrated over the Interstate Commerce Commission's (ICC) continued circumvention of intended safeguards provided in the Staggers Rail Act of 1980 against captive shipper abuses and anti-competitive practices by railroads. The net effects of such practices, including cancellation of joint rates and through routes and unreasonably high reciprocal switching charges, are denial to agricultural shippers of alternative rail routes and creation of monopoly powers for railroads over some market segments.

Although the ICC has improved its track record in a limited fashion, as illustrated by improved guidelines concerning product and geographic competition, the ICC continues to tip the scales overwhelmingly in favor of railroads. Recent decisions and actions by the ICC clearly demonstrate a continuation of this serious inequity.

The National Council firmly believes that Congress must enact legislation which would provide the ICC with clearer direction in the implementation of responsibilities in ensuring that a balanced, competitive environment exists.

We commend Senators Mark Andrews and Russell Long for introducing S. 477, The Consumer Rail Equity Act, and endorse its goals. The legislation was further improved by amendments recently incorporated by Senator Andrews, which reflect new ICC rules governing product and geographic competition in requiring railroads to provide that effective competition does exist. The National Council is also pleased that a number of other Senators have chosen to express their concern and the need for additional direction to ICC by cosponsoring S. 477.

Railroad deregulation cannot accomplish all of its intended objectives absent adequate competition—and government has the responsibility to provide a mechanism for the restoration of competitive pricing and service where the marketplace cannot, due to monopoly conditions.

FARMER COOPERATIVE SUPPORT FOR STAGGERS ACT

The National Council supported passage of the Staggers Rail Act in 1980. We continue to support the law's fundamental premise that the nation's railroads must be economically healthy and should operate within the discipline of the competitive marketplace without excessive government regulation. A strong, viable U.S. railroad industry is essential for railroads to continue to serve as a vital marketing link for American agriculture. Without adequate rail service, neither farmers nor shippers could satisfy demand for U.S. food and fiber because many areas do not have competitive transportation alternatives.

In areas where intermodal or intramodal competition exists, the Staggers Act is functioning reasonably well for farmer cooperatives. Our concern lies with the "captive" shipper who must market grain and/or farm inputs without the benefit of healthy competition. In the statement of purposes to the Staggers Act, Congress declared that" . . . it is the policy of the U.S. government to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and attract capital." Specific provisions were included in the final law to implement this policy.

ICC IMPLEMENTATION OF STAGGERS ACT

However, cooperative shippers are growing increasingly alarmed over the failure of the ICC to administer these captive shipper provisions of the Staggers Act as intended by Congress. The National Council believes the Commission has sidestepped its Congressional mandate that it preserve and foster effective competition in the railroad industry. Our specific concerns stem from the ICC's actions (or lack of action) on revenue adequacy and market dominance.

REASONS FOR FARMER COOPERATIVE CONCERN OVER STAGGERS ACT IMPLEMENTATION

Farmer cooperative concern over ICC misinterpretation of congressional intent of the Staggers Act focuses on rail cost and service. Railroad pricing is a serious farm income issue. Farmers are "price takers," not "price makers," and increased transportation costs cannot be passed on automatically to the consumer. The grain marketing chain offers the farmer a per bushel price that excludes transportation cost, since the price of grain is determined largely by the destination. The producer receives less per bushel the farther he is located from either of these locations due to higher transportation cost for his grain. Thus, as rail rates and reciprocal switching charges increase, the farmer simply receives a lower grain price. The price of farm inputs such as fertilizer and seed, is also higher, increasing farm production costs. In addition, any transportation cost increases absorbed by farmer cooperatives result in reduced patronage dividends returned to farmers-members. Therefore, the farmer is placed in triple jeopardy by rail price increases.

Contrary to the intent of the Staggers Act, captive agricultural shippers have been unable to prove that a rail rate is unreasonably high due to ICC techniques used to determine rail revenue adequacy. The Staggers Act allows a rail carrier to establish any rate for transportation unless it has market dominance, in which case the rate must be reasonable. Congress also directed the ICC to recognize the law's intent that carriers earn adequate revenues in determining rate reasonableness. In determining whether a railroad is revenue adequate, or profitable, the ICC decided to consider only one economic factor, the railroad's rate of return on investment versus the current cost of capital. There is not a single Class I railroad that is rated revenue adequate by the ICC even though several railroads have made substantial investments outside the industry. A strong and profitable railroad system does not mean extracting monopoly rent from American farmers to create excess profits or fund outside investments.

Railroad pricing practices can also determine the market area available to shippers. Today, railroads effectively have the ability to dictate joint rates and routes, reciprocal switching charges, and which shipper can get a contract on what terms. Faced with the inability of captive shippers to negotiate, rail carriers are empowered to determine which farmer cooperatives are able to market their members' grain and which cannot.

The following example illustrates this point. A farmer cooperative faced a reciprocal switching charge of $18 per jumbo hopper car in 1980. The full switching charge was absorbed by the receiving rail carrier and not charged to the shipper. In 1984, the switching charge jumped to $204 per car, a 1,033% increase over four years. Moreover, the receiving carrier did not absorb more than the original $18 per car. The cooperative was faced with the dilemma of either paying the remaining $186 per car or not buying any switched grain from its members. The cost of this additional switching charge is about six cents per bushel; yet cooperative profit margins are slim, sometimes only a fraction of a cent per bushel. As a result, the cooperative is unable to buy switched grain from its local elevator-members and is captive to one rail carrier due to excessive switching charges. The National Council believes this constitutes a restraint of trade and a reduction of competition among railroads.

The impact of the Staggers Act on captive agricultural shippers has been softened since passage of the law due to a hopper car surplus and weak demand for U.S. farm products. To cover fixed costs of operation, some rail carriers have been willing to offer shippers acceptable rates and contracts. However, today's examples of rail abuse spell even more problems that will become painfully evident, especially to captive shippers, as rail car supply shrinks relative to demand.

NEED FOR LEGISLATIVE CHANGE

The time to act on these problems is now, before fundamental changes to the infrastructure become so entrenched that it will be difficult if not impossible to remedy with limited, targeted action. The National Council urges Congress to take action to promote more rail competition and effective captive shipper treatment since, based on past performance, the ICC does not. Failure to do so will mean even greater shock waves through the agricultural marketing chain, shrinking farm income and reducing competition among railroads in the future.

It is both interesting and alarming to note that a number of the National Council's members have expressed a strong reluctance to step forward as individual shippers and identify the particulars of anti-competitive practices currently being experienced. Simply stated, they fear economic retaliation by the railroad involved. Where competition does not exist, the railroad now holds all of the cards And certainly the ICC does not presently serve as a balancing element in such circumstances, as originally intended by Congress. One can only conclude that the concern and caution exhibited by such shippers is regrettably justified.

CONCLUSION

In conclusion, the fate of the farmers and other captive shippers lies in the hands of Congress. It is unfortunate that this Subcommittee experienced scheduling problems which precluded the participation of a National Council witness. The National Council would request that this written statement be included as part of the November 1 and 4 hearing record. The National Council regards S. 477 as an appropriate Congressional response to these problems, and we would urge either the Subcommittee or the Full Committee to hold legislative hearings on S. 477 as soon as possible.

Statement of the National Association of Regulatory Utility Commissioners

Mr. Chairman and Distinguished Members of the Subcommittee:

This statement is submitted for the record to the Senate Committee on Commerce, Science and Transportation's Subcommittee on Surface Transportation on behalf of the National Association of Regulatory Utility Commissioners (NARUC).

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within our membership are the governmental agencies of the fifty States and the District of Columbia, Puerto Rico and the Virgin Islands engaged in the regulation of utilities and carriers. Our chief objective is to serve the public interest by seeking to improve the quality and effectiveness of government regulation.

The members of the NARUC greatly appreciate your invitation to address the Subcommittee on Oversight of the Staggers Rail Act of 1980. Since many of our members regulate electric utilities, we are deeply concerned with the prices electric utilities pay to transport domestic coal, as these prices are directly passed on to the ratepayers. To that end, the NARUC supports S. 477, the Consumer Rail Equity Act, which would clarify the intent of Congress regarding the Staggers Rail Act of 1980. This bill 1) would constrain the Interstate Commerce Commission (ICC) from using unorthodox regulatory practices to increase rail earnings above reasonable levels, and 2) which would provide rail shippers access to rail service that is competitive and priced fairly and reasonably.

Our statement will address two issues. The first is the protection against unreasonable rates for captive shippers and the second is our opposition to Federal preemption of State authority to regulate intrastate rail matters.

I. Protection Against Unreasonable Rates for Captive Coal Shippers

Captive coal shippers are in need of adequate protection against unreasonable transportation rates. Coal is the primary fuel for more than half of this country's electric generation. On a national average, transportation costs account for approximately one-third of the delivered price of coal shipped by rail. Moreover, there are almost no practical alternative or competing transportation modes, whether slurry pipelines, barges or trucks, to ship coal to end users. The result is that for half of the coal that utilities transport, they are captive customers of rail services.

A major factor in increasing the price of coal transport for captive shippers is the Interstate Commerce Commission (ICC), whose startling regulatory interpretation of the Staggers Act has provided little protection for captive shippers. In addition, the ICC refuses to regulate rail transportation rates using standards which have any relation to the costs of providing service. A comparison of the ratemaking standards employed by the ICC concerning monopoly rail rates with comparable utility standards highlights the ICC's failure to adequately protect captive rail shippers.

A. Determination of Revenue Needs

In determining the total revenues to be collected from electric utility ratepayers, State regulatory commissions calculate a utility's "revenue requirement". This total is derived by summing the utility's cost of service (labor, fuel, depreciation, materials, administrative expenses, etc) and its return on capital (return on depreciation rate base sufficiently to provide a reasonable profit to invested capital). Similarly, the ICC calculates the level of total revenues adequate to cover a railroad's annual costs plus a return on the capital invested in its plant and equipment. In both cases, this calculation is crucially important because it determines the systemwide rate levels which the regulated entity may charge. In the following areas, the ICC has chosen to use accounting and regulatory standards for more favorable to rail investors than State commissions would permit.

In determining utility rate base, State commissions use the original cost of investment. The ICC calculates the rail "investment base" based on current or replacement costs. In an inflationary economy replacement costs are higher than actual historic costs, and therefore rail rate levels will be increased.

In calculating a utility's cost of capital, State commissions use the actual cost (interest rates) of embedded debt. Although the costs of embedded debt are readily determinable, the ICC calculates the cost of rail debt on the basis of current bond and interest rates, again overstating actual costs.

In determining the overall cost of rail capital, the ICC assumes a debt-equity ratio of 37:63, while most utility calculations fall in the range of 50:50. Since equity is more expensive than debt, the ICC's ratio serves to increase rail revenue needs.

By the ICC's calculations, no Class I railroad, regardless of its profitability, its bonds ratings, or the level of its retained earnings, earns adequate revenues. In the wake of the proposed sale of Conrail to Norfolk Southern Railroad, it is nonsensical that the ICC has determined Norfolk Southern to be revenue inadequate, when the Department of Transportation has sanctioned the sale for $1.2 billion. A legislative remedy must be implemented to correct this disparity.

B. Stand-Alone Costs

Once a utility's or railroad's revenue needs are determined, regulators must design rates to allocate those needed revenues among the consumers of the monopoly's services. Under law, no individual utility ratepayer or (in theory) rail shipper should be charged rates exceeding a reasonable maximum. The ICC has determined that monopoly rail rates are not unreasonable as long as they do not exceed the "stand alone costs" of providing rail service to an individual shipper or group of shippers. *Ex part No. 347* (Sub No. 1) served September 3, 1985.

The concept of stand-alone costs (which is totally foreign to any system of electric utility regulation) means, in essence, that no rail rate is too high if it is less than the costs of serving an individual shipper or group of shippers as if these shippers were isolated from other rail consumers. In its purest form, this would mean that a railroad can charge a utility any rate it wants as long as that rate is less than it would cost the utility (on a per ton basis) to construct a brand new railroad to serve its generating plant, including the cost of right-of-way, track, bridges and other structures, equipment and the like. The concept of stand-alone rail costs is functionally equivalent to a State commission allowing a utility to raise its rates to a homeowner until the rates reached a per kwh level at which the homeowner would construct his or her own generating capacity.

C. Other Concerns

Other areas that are of concern to State regulators are the burden of proof and the misguided notion that if rail rates decrease electric utility profits will increase.

In proceedings before the State regulatory commissions, electric utilities bear the burden of proving that any change in rates is just and reasonable. Before the ICC, shippers bear the burden of proving that rates challenged as being too high are unreasonable. This allocation of the burden of proof is important because the ICC has made it difficult for shippers to obtain from the railroads the information necessary to challenge unreasonable rates and practices. Therefore, it is virtually impossible for a shipper to successfully challenge a rate or practice. This requires a legislative remedy unlike other areas which ICC interpretations.

In the debate surrounding the coal transportation issue, certain rail interests have suggested that legislation which serves to lower coal transportation rates would increase utility profits. This argument against legislative action assumes that State commissions will permit utilities to retain the amount of decreased transportation changes. This assertion is false. In every jurisdiction, annual rail transportation charges are recovered dollar-for-dollar from utility ratepayers as an expense item, in some cases through a fuel adjustment clause. Transportation costs are not a rate base item upon which a utility earns its profit. If rail rates increase by $200 million in a given year, total electric bills increase by that amount. If rates decrease, electric bills are lowered by the same amount. If reflected in a fuel adjustment clause, transportation cost changes are adjusted automatically in consumer bills. Therefore, no electric utility will "profit" by lowering its transportation costs

D. Conclusion

The ICC has adopted or proposed a program of policies and procedures to regulate monopoly rail service which no State regulatory commission would employ to regulate the rates of monopoly electric utilities. The ICC's policies have brought the country to the point where no railroad earns adequate revenues and no rail rates are unreasonably high. To correct these unbalanced policies and to provide protection for electric utility ratepayers who bear the costs of excessive coal rates, the National Association of Regulatory Utility Commissioners, as indicated in Appendix A in a resolution adopted on March 1, 1984, supports legislative initiatives to address this situation. Specifically, we urge the Congress to enact legislation which obtains adequate protections and access to competitive rail service for captive rail shippers and which obtains for consumers fair and reasonable regulation which protects them from exploitation.

The Consumer Rail Equity Act, S. 477 is the ideal legislation to combat this problem. The bill clarifies the intent of Congress regarding the Staggers Rail Act of 1980 by constraining the ICC from using aberrant regulatory practices and would provide rail shippers access to rail service that is competitive and priced fairly and reasonably. We respectfully urge the members of the Subcommittee to support S. 477 to curb the rail pricing abuses sanctioned by the ICC.

II. Federal preemption of State authority to regulate Intrastate rail matters

A. State Certification Requirement

The NARUC is strongly opposed to unwarranted Federal preemption of State authority to regulate intrastate rail matters. It is our belief that the public interest is best served when decisions materially affecting the quality of citizens' lives are made by officials who are easily accessible to those citizens. Therefore, the NARUC strongly advocates repeal of the State certification requirement contained in the Staggers Rail Act of 1980, 49 U.S.C. Sec. 11501(B) while leaving the Interstate Commerce Commission (ICC) free to engage in appellate review of State intrastate ratemaking decisions under 49 U.S.C. Sec. 11501(C) as revised.

Section 214 of the Act requires each State regulatory commission wishing to exercise jurisdiction over intrastate rail rates to be certified by the ICC. Forty States immediately filed requests to be certified, and it took five years from enactment of the Act for the ICC to grant the majority of them permanent certification.

The certification requirement contained in Section 214 of the Staggers Act is seriously flawed due to the absence of any federal guidelines to facilitate the development of reasonable and clearly articulated certification standards by the ICC. The absence of any clear standards in the Act resulted in inordinately lengthy proceedings to implement the act and in the ICC's questionable interpretation of the Act to require that State standards and procedures "mirror" the ICC's ratemaking rules.

The absence of any formal standards in the Staggers Act deprives State regulatory agencies of guidelines for use while developing their submission for certification to the ICC, leaving the extent to which the States have permissible discretion to regulate intrastate rates decidedly unclear. Moreover, the absence of formal standards has enabled the ICC to abuse the certification requirement.

The certification requirement contained in Section 214 of the Staggers Act has failed to further the Congressional intent underlying the Staggers Act. Instead, it has resulted in an extremely burdensome, unduly preemptive, and widely criticized review process by the ICC. Clearly, the present certification process, lacking any clear federal guidelines and never properly implemented, has no practical application. Therefore, the certification requirement should be repealed.

The States have played an historic role in regulating rail rates. The intrastate traffic patterns in each State are unique and each State should be permitted to continue to regulate rates in this area. By encouraging meaningful State consideration of intrastate rate cases, consumers and small shippers will be assured an opportunity to be heard in a local forum best situated to determine the uniquely local needs of both carriers and shippers.

Moreover, certification fails to effectuate the Congressional purpose to preserve the State role in promoting federally conforming intrastate rail rate regulation. If repealed, friction between the ICC and the States could be reduced dramatically while preserving fundamental principles of federalism. In addition, States would be free to develop innovative procedures and standards for intrastate rail rate regulation consistent with federal requirements from which the ICC and the nation as a whole could benefit.

B. Standard of Review

The NARUC is also concerned with the standard of review employed by the ICC for review of State rail rate decisions under 49 U.S.C. Sec. 11501(C). Under well-established principles of administrative law, the standard of review applicable to agency proceedings, unless clearly articulated by statute, is limited to the appellate function, where deference is granted to agency expertise. Here, although the ICC possesses expertise regarding the regulation of rail rates, each State authority possesses unique expertise as to the intrastate traffic patterns of the particular State. Therefore, we believe that the ICC should apply to its review of State rail rate regulation the deferential standard of review applicable to appellate review of ICC decisions. Unless Congress wants wholesale preemption of the State role in regulating intrastate rail rates, it should limit ICC review of State intrastate rail rate decisions to the appellate function.

Accordingly, the ICC should be bound by the State agency's factual decisions as long as there is substantial evidence in the record. State conclusions of law regarding the application of federal standards to the facts should be upheld unless clearly erroneous. State procedural decision-making should be upheld unless arbitrary and capricious. Thus, the ICC should restrict its scope of review to that set forth in the Administrative Procedure Act, 5 U.S.C. 706.

C. Conclusion

Attached in Appendix B is recommended legislative language reflecting our proposed amendments to the Staggers Act. Thus, a State authority would be able to exercise jurisdiction over intrastate rail matters without prior certification by the ICC. In addition, the ICC would be required to review a decision of a State authority upon petition of a party to its proceeding for conformity with federal law. Within 120 days after receipt of a petition, the ICC would be required to engage in appellate review of the matter as provided for under 5 U.S.C. 706 of the Administrative Procedure Act, remanding the matter to the State agency if inconsistent with federal law.

STATEMENT OF SHANE WOOLBRIGHT, EXECUTIVE DIRECTOR, MUNICIPAL ELECTRIC SYSTEMS OF OKLAHOMA

My name is Shane Woolbright. I am Executive Director of the Municipal Electric Systems of Oklahoma (MESO). We are an Association of 60 cities in Oklahoma and Arkansas who own and operate municipal electric distribution systems. Our cities get power from a variety of sources with 60% of the power being generated by coal-fired generating plants whose coal source is the Powder River Basin of Wyoming. Nearly all of that coal is carried by one shipper, the Burlington Northern Railroad.

MESO was and is a supporter of the Staggers Act as it was originally conceived and passed by the Congress. We believe that the act has not been implemented by the Interstate Commerce Commission as the Congress intended.

It has been clear in numerous decisions by the Interstate Commerce Commission (ICC) that the interests of shippers and consumers are not balanced against the railroads' revenue needs. Oklahoma's coal fired power plants, built in response to rising energy needs and escalating natural gas prices, were designed to burn low-sulphur coal from Wyoming. Until recently, only one railroad could deliver that coal to Oklahoma. But even with competition available at the mine, only Burlington Northern tracks reached some plants. The pricing structure for short hauls eliminates any savings competition may have had on rates at the mine mouth. Clearly a legislative remedy to such practices is necessary with the regulatory block inherent at the ICC today.

MESO, therefore, fully supports the Consumer Rail Equity Act as a proper response to the dearth of competition in the rail industry today and as a proper protection of shipper interests in captive markets.

The authors of the Staggers Act evidently recognized the coal costs for mining and transportation have a direct linkage to electric costs. The necessity to protest consumers and electric intensive industries was written into the Staggers Act. The need to have economic energy for consumers and industry is at least as important as the needs of the railroads for financial clout. Again, the ICC has not balanced those needs in any decision.

MESO appreciates the concern of this Subcommittee as shown by these hearings on this matter. We believe that testimony by captive shippers in these hearings will illustrate not only their problems but also the problems of wholesale customers whose fuel costs have continued to escalate even though costs of coal have been relatively flat.

We believe that the testimony presented here should be more than sufficient to justify legislative hearings on the Consumer Rail Equity Act. We urge each member of this Subcommittee to consider the consequences of non-competitive shipping costs on basic industry in America.

Having constructed multi-million dollar power plants to burn coal in an environmentally safe fashion using low-sulphur coals, we believe it is most improper that the sole source of efficient transportation of that product has free rein to set transportation rates in so cavalier a manner.

We would, therefore, urge this Subcommittee to fully support the legislation before you: The Consumer Rail Equity Act.

STATEMENT OF RONALD G. WASSON, VICE PRESIDENT—PURCHASING, KANSAS CITY POWER & LIGHT CO.

Mr. Chairman: I am pleased to be able to present written testimony to this Committee on the experience of those dependent upon railroads for transportation and who are victims of the ICC's failure to implement provisions of the Staggers Rail Act.

Kansas City Power & Light Company (KCPL) is a medium size electric utility and the corporate successor to one of the world's first electric companies, generating electricity since 1882. Headquartered in downtown Kansas City, Missouri, the Company generates and distributes electricity to about 363,000 customers in a 4,700 square mile area located in all or portions of 23 counties in western Miseouri and eastern Kansas. Population of the service area is about 825,000.

KCPL operates four coal fired power plants providing most the Company's electric generation. During 1984, 6.6 million tons of coal were shipped by railroad to these four plants at an estimated cost of $95 million.

The purpose of my testimony is threefold:

1. To discuss KCPL's experience as a captive shipper since passage of the Staggers Rail Act;
2. To demonstrate the ICC's failure to implement the provisions of the Staggers Rail Act intended to provide protection for captive shippers;
3. To express support for S. 477, the Consumer Rail Equity Act.

KCPL IS A CAPTIVE SHIPPER

Shipper captivity is not an illusory concept as others have alluded, but it is a real and significant problem. Three of the four coal fired generating plants are dependent on a single railroad for delivery of coal supply.

KCPL presently ships 5.3 million tons of Powder River-Wyoming coal annually to its electric generating stations in the Kansas City area. Each shipment generally consists of 110 KCPL-owned coal cars, each loaded with about 100 tons. These 11,000-tone movements traverse the 1600-mile round trip route each 4.8 days. Barge transportation is not available from arid Wyoming. Truck transportation is available but it would take some 774 trucks carrying 25 tons each, traveling at 55 miles per hour, 24 hours per day, 365 days per year, to deliver the annual 5.3 million tons required. That would space the trucks about 12,000 feet apart in a continuous two-way stream up and down the highway between Wyoming and Kansas City and a truck would meet another going the other way every 1.2 minutes. Air transportation quite obviously is not a practical means of shipping large quantities of coal to remote power plants. Consequently, KCPL is captive to the railroads for coal shipments and more importantly captive to specific railroads when one railroad has access to the mines and plants involved. KCPL did not become a captive shipper by design, since each of our coal fired plants were constructed prior to 1980, when ICC action was available to protect our customers from the excesses of monopoly rail pricing. The ICC's inaction since passage of the Staggers Act has created a situation of shipper captivity leading to significant increases in freight rates.

CUSTOMERS ADVERSELY IMPACTED

KCPL's electric customers have been adversely impacted by the Interstate Commerce Commission's refusal to enforce provisions of the Staggers Rail Act pertaining to captive shippers. The overall effect is that each KCPL customer now pays more than $15 per month for rail transportation of coal compared to less than $10 per month prior to passage of the Staggers Act. This more than 50% increase in average freight costs shown on Table 1 has resulted primarily from freight rate increases taken by the railroads and is borne by our customers as an increased cost of electricity.

ICC FAILURE TO PROTECT CAPTIVE SHIPPERS

KCPL's experience under ICC administration of the Staggers Act can be exemplified by the events at Iatan Station. In May of 1980, KCPL entered into a pre-Staggers Act agreement with Burlington Northern (BN) for delivery of coal to Iatan from the Powder River Basin. BN filed tariffs in late 1981 abrogating the agreement by posting a 15 percent rate increase above contract rates which had been adjusted for inflation. KCPL brought suit against Burlington Northern in Federal District Court to enforce provisions of the May, 1980, agreement. The Court found that KCPL did have a contract; however, it was unenforceable because the parties had failed to clearly state the terms of duration.

KCPL then filed a complaint case with the ICC in an effort to protect our customers from this unwarranted increase. The Commission determined in April, 1983, that KCPL was paying a revenue to variable cost ratio significantly above the Staggers Act threshold test for ICC jurisdiction. The ICC, however, determined the rate to be "reasonable" and would not order an investigation asserting that higher rates than KCPL's had been found "reasonable" and the BN was "revenue inadequate." However, a few months later the "revenue inadequate" BN was able to purchase El Paso natural gas for $1.3 billion. KCPL met the criteria established in the Staggers Act but was denied the protections afforded captive shippers as a result of ICC administrative action. A few weeks later in May of 1983, an ICC administrative law judge summarized the shipper's dilemma by stating that the Commission has no intention of findig a rail rate, ". . . no matter how high, to be above a maximum reasonable level." Consequently, the freight rates at Iatan have risen 47 percent or almost $11 million on an annual basis since passage of the Staggers Act as shown in Table 2.

The Rail Cost Recovery Index (RCRI) compiled by the Association of American Railroads to measure increases of rail costs is also shown in Table 2. The RCRI increased by only 27 percent during the period that Iatan freight rates increased 47 percent, indicating a rate of increase in Iatan freight rates 73 percent greater than the rate of railroad cost increases.

COMPETITION IS NOT AVAILABLE TO CAPTIVE SHIPPERS

Since August of 1984 when CNW-UP gained rail access to some mines in the Powder River Basin, KCPL has attempted to use competition to break the stranglehold of Iatan rail captivity; but, significant barriers are faced because only BN can make deliveries. In an effort to free Iatan from captivity, KCPL is investigating construction of a rail bridge across the Missouri River to gain access to a competiting rail carrier.

This impacts of shipper captivity at Iatan are illustrated by our economic studies which show construction of a new $28 million rail bridge would produce significant savings for our customers by provising competition for the freight. Why are the rates quoted by the carrier with monopoly power so high that savings would result from construction of an unnecessary $28 million bridge? Theoretically, under Staggers Act provisions, the construction of a bridge would not be required since the Act provides for ICC regulation or competitive access where competition is not available. However, under current ICC regulatory policy of ignoring the needs of captive shippers, the only practical alternative is the expensive construction of a bridge to open up competition. Shippers captivity at Iatan Station is costing KCPL customers an estimated $4 to $6 million per year.

PROTECTION IS REQUIRED FOR CAPTIVE SHIPPERS

Prior to passage of the Staggers Act in 1980, KCPL entered into agreements with the Burlington Northern Railroad regarding the freight rates to the Iatan and LaCygne Stations. BN notified KCPL in 1981 of their intent to exercise "pricing freedom" under the Staggers Act without regard to prior commitments. KCPL went to Federal District Court to seek enforcement of the agreements. We lost the Iatan case, as earlier discussed, and won the LaCygne case. KCLP's hard-fought defense of the LaCygne agreement saved our customers an estimated $65 million from the onerous increases propsed by BN.

The attempted abrogation of these agreements by BN clearly illustrates railroad intent to maximize captive shipper revenues in light of the ICC's refusal to implement Staggers Act protections.

Those who state that the Staggers Act is working properly are fond of quoting that the Commission has ruled in favor of the shipper in 50 of 68 captive commodity cases. In fact, the Commission found market dominance in 50 of 68 cases denoting that captive shippers were subject to monopoly power—but the record of final decisions by the Commission is far less favorable. Since passage of the Staggers Act, no coal shipper has prevailed in a final decision by the Commission.

The ICC recently promulgated coal rate guidelines in the Ex Parte 347 proceedings which allow rates to be increased until they reach "stand alone cost" or the point where the shipper could build, own and operate his own railroad more economically. But ICC rulings have shown that even this unreasonably high cost does not serve as a practical limit to the Commission's findings of "reasonable" rates.

In a recent ICC decision in Docket No. 39687 dated April 15, 1985, involving Platte River Power Authority, the Administrative Law Judge determined the rate paid by Platte River Power Authority to be in excess of "stand alone cost" as defined by the ICC's Ex Parte 347 Coal Rate Guidelines. Stand alone costs include all relevant costs of owning and operating a private railroad; consequently, the variable cost is already included in that figure. Inexplicably, the Administrative Law Judge added the variable cost of the carrier involved to the "stand alone cost" developing an artificial rate limit higher than the rate being paid by the captive shipper. This "double count" typifies the incompetent performance of the ICC which myopically focuses on the single issue of revenue adequacy without regard to the broader public interest of electric consumers who pay monthly for this uneven treatment.

In view of the coal shippers' failure to win even one case at the Commission since passage of the Staggers Act and the new coal rate guidelines which are so ambiguous as to be useless, the captive shipper has only one place to turn, legislation. The Consumer Rail Equity Act is an effective means of providing captive shippers the protection from excessive rail rates intended when Congress passed the Staggers Rail Act. The passage of S. 477 would relieve the burden of excessive rail rates borne by KCPL customers and would have no direct impact on KCPL's profitability because savings realized would pass through to electricity consumers. Additionally the Consumer Rail Equity Act would not "reregulate" the railroad industry, but would allow competition to work where it exists and the benefits of that competition would continue to be realized by non-captive shippers.

TABLE 1.—KANSAS CITY POWER & LIGHT CO. COAL SHIPMENTS & FREIGHT COSTS 1980–84

Year	Coal shipped (tons)	Freight cost (EOY $)	Average freight (EOY $/ton)	Average freight (percent increase)
1980	4,433,862	$40,933,276	$9.2320	
1981	3,897,383	46,161,772	11.8443	28.3
1982	3,850,203	47,986,036	12.4632	5.2
1983	3,829,682	52,452,781	13.6964	9.9
1984	4,598,586	66,318,003	14.4214	5.3
Percent increase since Staggers Act (Dec. 31, 1980 to Dec. 31, 1984)	3.7	62.0	56.2	

TABLE 2.—KCPL IATAN FREIGHT RATES (BN) 1980–85

Effective date	Iatan	RCRI quarter value	RCRI (percent change)
July 1, 1980	9.710	143.0	
October 1, 1980	9.750	144.7	1.19
January 1, 1981	10.500	152.2	5.18
April 1, 1981	10.530	156.6	2.89
July 1, 1981	11.190	160.6	2.55
October 1, 1981	11.230	163.3	1.68
December 30, 1981	12.900	163.3	0.00
January 1, 1982	12.900	168.3	3.06
April 2, 1983	13.640	170.7	1.43
October 9, 1983	13.660	176.3	3.28
January 1, 1984	14.220	181.3	2.84
July 1, 1984	14.270	181.8	0.28
April 1, 1985	14.270	182.6	0.44
Percent increase (July 1, 1980—April 1, 1985)	47.0	27.7	

STATEMENT OF J. RAYMOND CLARK ON BEHALF OF SOUTH CAROLINA PUBLIC SERVICE AUTHORITY

This statement is submitted on behalf of and as transportation counsel for South Carolina Public Service Authority, popularly referred to as Santee Cooper. Santee Cooper is a non-profit instrumentality of the State of South Carolina, providing electric service to residential, commercial and industrial customers throughout a substantial service area in that state. As such, Santee Cooper purchases and consumes about four million tons of coal at its four coal-fired generating stations in South Carolina. Virtually all of this coal moves in single-line rail service (in substantial part in Santee Cooper's rail cars) via the Seaboard System, one of the operating carriers in the CSX System, which is the only railroad serving each of the generating stations. Santee Cooper is, therefore, a captive coal shipper in every sense of the word. As such it strongly supports enactment of the Consumer Rail Equity Act.

Santee Cooper has even been conscious of its duty to minimize the cost of electricity to its customers and has been vigorous in its efforts—antedating the Staggers Act—to obtain reasonable freight rates on coal both through negotiation and litigation before the I.C.C. I have represented Santee Cooper in these efforts, most principally in the latter regard.

To briefly recite my qualifications, I have been practicing before the I.C.C. since 1954. For about the last 10 years my practice has focused primarily upon representation of utility rail coal shippers. I had the privilege of participating with members of the Committee and the Committee's staff, along with rail, shipper and public agencies in many of the discussions that preceded enactment of the Staggers and am fully aware of the effort made to reconcile divergent interests under a balanced regulatory approach that would recognize the legitimate need for protection of captive shippers. Regrettably, the balance so carefully structured by the Congress has been subverted by the I.C.C. both through affirmative distortion of the intent of the Act and through unwarranted delay in deciding rate cases while indulging in a seemingly endless search for "final" standards of maximum rate reasonableness. Both misinterpretation of the Act and interminable delay have worked to the obvious detriment of the shippers. Based upon my years of experience before the I.C.C. I can state in all candor that the post-Staggers years have been largely a frustrating—and costly—exercise in futility for shipper counsel and their clients.

I am aware of only one coal rate proceeding in that time in which the I.C.C. has granted relief to the shipper: No. 37276 (Sub-No.1) *Coal, Wyoming to Redfield, AR* (364ICC988, served May 28, 1981). In that case, in which it happens I was counsel of Arkansas Power & Light Company, the I.C.C. ordered a reduction in the then rate of 12 cents a ton. ($18.75 to $18.63) and awarded reparations on past shipments. The rate increase was made effective but more than offset by an authorized increase later that year. The reparations have never been paid. The decision was subsequently vacated by the court upon request of the I.C.C. and the railroads and is still pending at the I.C.C. Indeed, by I.C.C. decision of October 3, 1985, the *Redfield* case, along with other pending coal rate proceedings, was once again reopened, this time to permit of further evidence and argument under the revised 1985 Guidelines.

Santee Cooper had a similar experience but concluded to settle rather than continue apparently endless litigation before the I.C.C. It filed a complaint with respect to the rail rates to its three principal generating stations. After hearing an I.C.C. administrative law judge served a decision on June 22, 1981. (No. 37338, *South Carolina Public Service Authority* v. *Clinchfield Railroad Company et al.*) in which he ordered substantial rate reductions ($8.12 instead of $9.33 and $9.30 reduced from $10.63 per ton) and payment of some reparations. Appeals were timely filed but no final decision issued. Instead, on April 7, 1982 the I.C.C. reopened this and other coal rates cases for new evidence. Faced with further litigation expense and delay, Santee Cooper negotiated a contract with the Seaboard system railroads for some of its traffic, and, pursuant to that agreement, in June 1983 requested that its complaint case be dismissed. Contract discussions as to its other coal movements have since been ongoing, albeit on a sporadic basis.

It must be readily apparent that contracting with railroads under the described circumstances does not afford the utility very much bargaining leverage. While the litigation is delayed the shipper continues to pay the rates complained of. The presentation of evidence under ever-changing I.C.C. standards of rate reasonableness is burdensome, time-consuming and costly—with little assurance of relief. Santee Cooper does not, of course, suggest that the contract option provided by the Staggers Act is not preferable to litigation. The contract option, however, affords no realistic protection for captive coal shippers unless there also exists either or both a meaningful regulatory alternative that places the parties in an equal bargaining posture and/or competitive rail service. That regulatory alternative has been effectively emasculated by a rail-oriented I.C.C., contrary to the legislative intent of the Staggers Act. Clearly, the only way to bring the rail-shipper scales of justice back to near equilibrium is for the Congress to send a message to the I.C.C. through passage of the CURE bill, that it meant what it said about fair treatment of captive shippers—and most particularly coal shippers—in the Staggers Act notably including the Long-Cannon Amendment, or to end this captivity by providing competitive access.

I should point out that Santee Cooper faced an additional obstacle in its litigation effort before the I.C.C. that is not typical of other utilities. As a governmental instrumentality Santee Cooper's rail rates were "quoted" under former Section 22 of the Interstate of the Interstate Commerce Act (now 49 USC 1972) rather than filed in tariffs with the I.C.C. The theory, of course, of this section was to permit the railroads to offer preferential rates to the government. In practice, the quotes have been at the same level as other rates. Yet, the I.C.C. has held that the rate quotes, not being filed tariffs, cannot be attacked as unreasonable. As a consequence Santee Cooper does not even have the dubious privilege of invoking I.C.C. jurisdiction to protest a rate increase.

In order to place Santee Cooper's freight bill for coal in some perspective, it should be observed that rail transportation is about 25 percent of energy costs. The impact of transportation upon Santee Cooper's electric rates is, therefore, significant. Rail rate relief is even more important now than before because of the economic woes of Santee Coopers major industrial customers. Three principal customers, including an alumina reduction plant—which is highly energy intensive—are experiencing marketing problems already reflected in plant layoffs. Obviously, a passthrough to industrial customers of a rail rate reduction will not solve all of these problems but it would certainly help both customers and Santee Cooper, also encountering decreased sales of electricity. The economy of Santee Cooper's service area would also be stimulated by reasonable freight rates on coal. Approval of the proposed legislation is essential to this end and in furtherance of public policy.

Statement of Southern California Edison Co.

INTRODUCTION

Southern California Edison Company ("SCE") endorses the provisions of the proposed Consumer Rail Equity Act. SCE believes this legislation is necessary because of the failure of the Interstate Commerce Commission ("ICC") to effectively implement the intent of the Staggers Rail Act ("Staggers Act") to assure that rates charged to captive coal shippers are fair and reasonable.

Approximately two thirds of the coal consumed by electric utilities in 1984, or about 460 million tons, was transported by rail. The cost of rail transportation often equals or exceeds the cost of coal alone. In 1984, electric utilities paid more than $5 billion for the rail transportation of coal, and this expense was borne by electric consumers.

DISCUSSION

When Congress passed the Staggers Act in 1980, the need to protect shippers captive to a single railroad was recognized. The Staggers Act specifically states that it is the policy of the United States government:

". . . to maintain reasonable rates where there is an absence of effective competition."

In this regard the Conference Report on the Staggers Act makes particular reference to captive coal shippers:

"The Conferees intend that this policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition."

Unfortunately, these congressional directives have not been reasonably implemented by the ICC which has yet to find that any captive coal shipper rate is unreasonable. An ICC administrative law judge summarized this situation as follows:

"The bottom line . . . is that the Commission . . . does not intend, as can be seen from both its actions and inactions, to find a rail rate, *no matter how high*, to be above a maximum reasonable level." (emphasis added).

A substantial portion of the SCE's present and future energy needs is dependent on coal. SCE has pioneered efforts to develop environmentally superior approaches for generating electricity from this abundant resource. This is most recently evidenced at the Cool Water Coal Gasification facility in California. Obviously, future development of this and other coal conversion technologies is dependent upon the economics of delivered coal costs. SCE is concerned that the negative experience of captive coal shippers under the Staggers Act, if not reversed, will discourage the advancement of these necessary technologies.

SCE agrees with the sponsors of the Consumer Rail Equity Act that this legislation offers the only timely and effective remedy of the current situation, and is required in order to afford captive coal shippers reasonable protection.

SCE PROFILE

SCE is an investor-owned electric utility which provides electric service in a 50,000 square-mile area of central and southern California. This area, which has a population of more than 9 million people, includes some 800 cities and communities.

SCE's gross investment in utility plant totals approximately $12.8 billion. Area generating capacity at peak during 1984 totaled 17,354 megwatts (MW), which included 14,819 MW of SCE facilities and 2,535 MW of capacity from other sources. Of the SCE facilities, 70 percent was comprised of oil and gas-fired generation, coal-fired generation represented 11 percent, 6 percent was hydroelectric generation, and nuclear generation accounted for 13 percent. In addition to its direct ownership interest in coal-fired powerplants, SCE is substantially dependent upon coal-fired energy purchased from other electric utilities throughout the western United States.

STATEMENT OF WILLIAM J. FOGARTY, ADMINISTRATOR, TRANSPORTATION DIVISION, MONTANA DEPARTMENT OF COMMERCE

Mr. Chairman, Members of the Committee, my name is Bill Fogarty. I am the Administrator of the Transportation Division, Montana Department of Commerce. I appreciate the opportunity to supply testimony in support of S. 477.

Montana's rail system consists of approximately 3,500 route miles of track operated primarily by three Class I Carriers (Burlington Northern Railroad, Soo and Union Pacific) and two recently-born short line carriers. Of this total, 825 miles are branch lines.

The dominant carrier is the Burlington Northern Railroad (BNRR) which operates over 91 percent of the route miles covering all portions of the state. The Burlington Northern serves 98 percent of the grain elevators in Montana and all the elevators with 26 and 52 car facilities with the exception of a 52 car facility at Butte on the Union Pacific System.

Since 1979, BNRR has abandoned 16 lines constituting a total of 400 route miles. Ten of these lines have been abandoned since 1983. In addition, the 66 mile Spring Creek Junction to Geraldine line was transferred to the newly created Central Montana Rail (CMR) short line as a result of a lawsuit settlement between the State of Montana and the BNRR.

An agreement consummated recently between the Butte, Anaconda & Pacific Railway Co. (BA&P) and the State of Montana resulted in the creation of RARUS, a new company that will operate a short line railroad in southwestern Montana, including over 43 miles of trackage previously served by the BA&P.

ON their System Diagram Map, BNRR currently has one line in Category 1 (Railroad Preparing Abandonment Applications) constituting 28.5 route miles. Two lines are in Category 3 (Railroad Filed Abandonment Applications) constituting 15 miles.

The total number of miles abandoned by all carriers in the state since 1979 is 1,251 miles.

Besides the socioeconomic hardships caused to producers, shippers and businesses along the lost branch lines, the impacts on the areas' road systems caused by the diverted rail to truck traffic is devastating. On just one 66 mile branch line serving a grain area in central Montana, the state estimates the annual added highway impact costs to be at least $4.6 million.

From Exhibit I, the map of Montana's rail system, you will note that the BNRR trackage virtually blankets Montana, with the minor exceptions of the Soo Line in the extreme northeast corner and a Union Pacific branch line in the extreme southwest corner.

Upon comparing Montana's grain rates to states such as Colorado, Kansas, and Nebraska, our rates are consistently higher on a per car mile earning basis when comparing hauls of like commodities and distances. For example in Exhibit II attached, single car rates on a per car mile earnings in Montana, range from $.48 to $1.60 per cwt higher. The increased revenues to BNRR from Montana's excessive rates on 26 car shipments range from $10,062 to $21,866 and to $25,480 to $45,760 for 52 car shipments.

In Montana, Burlington Northern's revenue to variable cost ratio on hard red wheat is 240 percent compared to BNRR's average earnings in other states on hard red wheat of 185 percent. Carriers other than Burlington Northern moving hard red wheat to the Pacific Northwest earn an average of 114.3 percent of revenue to variable cost. Let me clarify this with an example used by BNRR in the September, 1984 Senate Judiciary Committee Hearing. The BNRR grain rate from Omaha, Nebraska, to Pacific Northwest Ports and from Wolf Point, Montana, to Pacific Northwest Ports are as follows:

Wolf Point to Portland = 1,087 miles

Cars	Rate/Cwt	Loaded revenue per ton mile	Per car mile earnings
54	.161	.02962	$2.90

Omaha to Portland = 1,880 miles

Cars	Rate/Cwt	Loaded revenue per ton mile	Per car mile earnings
54	.154	.01638	$1.55

The facts show that BNRR's rate in Montana, is 4.5 percent higher than Omaha, but they earn 80.8 percent more per loaded ton mile and 86.6 percent more when put on a per car mile earnings basis out of Montana.

In 1981, the Montana grain producers filed a class action suit against the BNRR stating the grain rates in effect for the period of 1978–1980 were excessive. An ICC law judge in December, 1981 determined the BNRR did have market dominance in Montana, and that some rates were as high as 292 percent of revenue to variable costs. The BNRR then appealed the case to the full ICC. The ICC failed to make a decision on the case for approximately two years. In 1984, the ICC reopened the case saying market dominance and rate reasonableness had to be reproven under the definitions currently in place. The Montana grain producers have spent over $400,000 to cover expenses on the case thus far. The last Montana's legislative session approved an additional $310,000 for the state to assist in the case for the next two years. The ICC, through its delays and pro railroad bias, have done nothing to protect the captive shipper.

The reason for the lower rates in neighboring states is clear—competition. These states either have access to other rail competition or barge transportation. Since we are a state lacking competitive modes of transportation and the fact that we are a major producer and shipper of raw bulk commodities, mainly coal, grain and lumber, adequate and economical rail transportation is vital to keeping our products market competitive.

Montana's only other transportation alternative for bulk commodities is truck, which is substantially less efficient in the transportation of bulk commodities over long distances.

Average rail costs per net ton mile to move wheat from Montana to Pacific North Coast are 1.9 cents. Truck/barge movements average 3.25 cents per net ton mile. The river transfer charge is $2.70/ton is not included in truck/barge costs, but would further increase these costs to make them even less competitive with rail movements. The lowest truck/barge costs per net ton mile exceeds the highest Burlington Northern costs. The fact is that the truck/barge does not provide effective competition that would constrain rail rates.

The Burlington Northern far exceeds the 2,500 level of Herfindahl-Hirschman Index which the U.S. Department of Justice uses to determine whether a company is in a monopoly position. For Pacific Rim markets, the Index for Burlington Northern is 3,588; for Asia and for the Pacific Rim it is 2,652.

We know that a financially healthy rail system is vital to our economy. We also understand that the Staggers Act is apparently working well where intra and intermodal competition exists. We do not feel the ICC has properly interpreted and carried out the congressional intent of Staggers, particularly in areas pertaining to captive shippers, rate reasonableness and determination of revenue adequacy. S. 477

would breathe life back into the captive shipper provisions of the Staggers Act. We also support S. 447 which brings the benefits of competition to shippers and consumers where possible.

EXHIBIT NO. II.—COMPARISON OF CAR MILE EARNINGS REVENUE IN CENTS/CWT FOR CARLOADS OF GRAIN FROM MONTANA TO PORTLAND VS COLORADO, KANSAS, AND NEBRASKA TO HOUSTON

[Montana minimum weight 196,000; Colorado, Kansas and Nebraska minimum weight 190,000; Rate/Cwt, Single Car]

Origin points	Actual miles	Rate per CWT (cents)	Revenue/car [1]	PCME [2]
Meriwether, MT	733	158	$3,097	$4.225
Fredonia, KS	733	101	1,919	2.618
Difference		57	1,178	1.607
Townsend, MT	785	152	2,979	3.795
Olathe, KS	790	105	1,995	2.525
Difference		47	984	1.270
Joplin, MT	833	162	3,175	3.812
Leavenworth, KS	839	128	2,432	2.899
Difference		34	743	.913
Kershaw, MT	890	158	3,097	3.480
Lyons, KS	896	104	1,976	2.205
Difference		54	1.121	1.275
Moccasin, MT	938	163	3,195	3.406
Humbolt, NE	946	138	2,622	2.772
Difference		25	573	.634
Billings, MT	987	163	3,195	3.237
Omaha, NE	1,005	138	2,622	2.609
Difference		25	573	.628
Hardin, MT	1,045	174	3,410	3.263
Fremont, NE	1,047	138	2,622	2.504
Difference		36	788	.759
Wolf Point, MT	1,087	196	3,842	3.535
Denver, CO	1,083	174	3,306	3.053
Difference		22	536	.482
Culbertson, MT	1,141	196	3,842	3.367
Kearney, NE	1,147	161	3,059	2.667
Difference		35	783	.700

Origin points	Actual miles	Rate/CWT (cents)	Revenue car [1]	PCME [2]	Earnings on 26 cars [3]
Meriwether, MT	733	135	$2,646	$3.610	$841
Fredonia, KS	733	95	1,805	2.462	x 26
Difference		40	841	1.148	21,866
Townsend, MT	785	134	2,626	3.345	
Olathe, KS	790				
Difference					
Joplin, MT	833	138	2,705	3.247	539

Origin points	Actual miles	Rate/CWT (cents)	Revenue car [1]	PCME [2]	Earnings on 26 cars [3]
Leavenworth, KS	839	114	2,166	2.582	x 26
Difference		24	539	.665	14.014
Kershaw, MT	890	135	2,646	2.973	
Lyons, KS	896				
Difference					
Moccasin, MT	938	139	2,724	2.904	387
Humbolt, NE	946	123	2,337	2.470	x 26
Difference		16	387	.434	10,062
Billings, MT	987	144	2,822	2.859	485
Omaha, NE	1,005	123	2,337	2.325	x 26
Difference		21	485	.534	12,610
Hardin, MT	1,045	146	2,862	2.739	x 525
Fremont, NE	1,047	123	2,337	2.232	x 26
Difference		23	525	.507	13.650
Wolf Point, MT	1,087	176	3,450	3.174	391
Denver, CO	1,082	161	3,059	2.825	x 26
Difference		15	391	.349	10,166
Culbertson, MT	1,141	176	3,450	3.024	695
Kearney, NE	1,147	145	2,755	2.402	x 26
Difference		31	695	.622	18.070
Meriwether, MT	733	120	2,352	3.209	547
Fredonia, KS	733	95	1,805	2.462	x 52
Difference		25	547	.747	28,444
Townsend, MT	785	120	2,352	2.997	490
Olathe, KS	790	98	1,862	2.356	x 52
Difference		22	490	.641	25,480
Joplin, MT	833	123	2,411	2.894	549
Leavenworth, KS	839	98	1,862	2.219	x 52
Difference		25	549	.675	28,548
Kershaw, MT	890	120	2,352	2.643	509
Lyons, KS	896	97	1,843	2.057	x 52
Difference		23	509	586	26.468
Moccasin, MT	938	124	2,430	2.591	416
Humbolt, NE	946	106	2,014	2.129	x 52
Difference		18	416	.462	21,632
Billings, MT	987	129	2,528	2.561	514
Omaha, NE	1,005	106	2,014	2.004	x 52
Difference		23	514	.557	26,728
Hardin, MT	1,045	136	2,662	2.551	652
Fremont, NE	1,047	106	2,014	1.924	x 52
Difference		30	652	.627	33,904
Wolf Point, MT	1,087	161	3,156	2.903	420

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Origin points	Actual miles	Rate/CWT (cents)	Revenue car [1]	PCME [2]	Earnings on 26 cars [3]
Denver, CO	1,083	144	2,736	2.526	x 52
Difference		17	420	.377	21,840
Culbertson, MT	1,141	169	3,312	2.903	880
Kearney, NE	1,147	128	2,432	2.120	x 52
Difference		41	880	.783	45,760

[1] Rate x minimum weight = revenue/car.
[2] Revenue/car ÷ actual miles = per car mile earnings.
[3] Difference in revenue/car x number of cars in shipment.

STATEMENT OF THE GEORGIA MUNICIPAL ASSOCIATION

GMA would like to review several areas of concern which municipalities in Georgia are experiencing with rail abandonment as a result of the Staggers Act. First, let me state that GMA does not oppose rail line abandonment in every instance. In some cases, the decision by the rail carrier to abandon a line may be valid. However, there has been a marked escalation of rail line abandonment, particularly by the Seaboard Railway System. Since 1977, a total of 348 miles of track have been abandoned, resulting in the reduction of the state's total rail system by over 10 percent.

Currently, 154 additional miles of rail line is either proposed or under study for abandonment. If these proposed abandonments are ultimately approved, the State of Georgia will have lost over 600 miles of rail line in the past seven years.

These abandonments are impacting rural communities which have been served by rail for over 100 years, and the economies of these communities are being impacted as well. South Georgia's major industry is agriculture. Because of the nature of agricultural products they are generally shipped by rail. The loss of rail is particularly harmful to this industry.

GMA has four major concerns with the provisions of the Staggers Act which relate to rail abandonment. These concerns are reviewed below.

1. The Act makes it virtually impossible to successfully oppose rail line abandonment. Since the Act's inception, the ICC has denied a very small number of proposed abandonments nationwide. Two of those were in Georgia, and were very costly to oppose. Congress should clarify the legislative intent of the Staggers Act in the area of rail line abandonments. Specifically, Congress should address how they intended to weigh the impact on the shippers and the community losing rail service against the burden upon the railroad of continuing rail service.

The present procedures for the abandonment of rail lines (49 C.F.R. Part 1152) should be modified to require that railroad companies provide specific information concerning traffic trends, profitability and rail line condition to rail users, local and state governments six months prior to the filing of the abandonment application.

Under present abandonment procedures this information is not available to interested parties until the abandonment application is filed. Since there are only thirty days within which to file a protest, adequate time to analyze the basic information concerning the rail line and explore alternative actions is not available.

2. If an abandonment is successfully opposed, the rail carrier can immediately propose abandonment of the same rail line again. Presently, the Act does not require any waiting period.

If a railroad company application to abandon a rail line is denied by the Interstate Commerce Commission (ICC), the railroad company should be required to continue rail service for two years from the date the application is denied. During the two year period the railroad company should be required to negotiate in good faith with the involved parties for the long term continuation of rail service. During this period, the railroad should also make an effort to resolve the problems which originally warranted the abandonment of the rail line. Upon the expiration of the two year period the ICC could judge the efforts on the part of the railroad company and the involved parties to resolve the situation in determining whether the case should be reopened.

Under present abandonment procedures, if a rail line abandonment is denied the railroad can immediately be placed in ICC Category I and the abandonment process reinitiated. Effectively, there is no way for shipper and local interests to win in an abandonment proceeding.

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3. Oral hearings should be held in or near the communities on which petitions for abandonment have been filed, if the abandonment is opposed. The Act presently provides for oral hearings or written protest. Since abandonments can have a serious impact upon the economy of a community, the shippers, Chambers of Commerce, and elected officials of the community should have an opportunity to make their case in a location which is accessible to those wishing to provide oral testimony.

4. Communities which have developed a strategy to attract industries cannot succeed if the industry needs rail service, and the rail companies publish an intent to abandon or to study abandonment at the same time the industry may have that particular community under consideration. We have several instances of this happening in Georgia.

For example, segments of the Bainbridge to Columbus line are being "studied" for abandonment by the Seaboard Railway. This area of the state is also served by the Tri-Rivers, the Chattahoochee-Appalachicola-Flint. Over the past five years, barge traffic has increased greatly as a result of a major undertaking by the Corps of Engineers to clear the river channel of rocks which had previously hampered the movement of barge traffic on the rivers.

The Tri-Rivers traffic is complemented by rail service which transports a variety of agricultural and mineral products to and from the river. Improvements in the river channel have enhanced opportunities for economic development throughout this area of southwest Georgia.

Loss of rail service would greatly diminish the chances which these communities have to attract industry. Yet industry is not likely to take a chance on locating in southwest Georgia if there is a likelihood of losing rail.

Thank you for the opportunity to present this testimony on behalf of Georgia's municipalities.

STATEMENT OF DWIGHT KEATING [1]

Since enactment of the 4-R Act in 1976 rail rates for coal haulage have increased in constant dollars by over 40 percent while the minemouth price of coal has declined by approximately 20 percent. This increase in the price for moving coal has occurred at the same time the costs of coal transportation were decreasing through increased use of unit trains, improved coal cars and loading facilities and other technological innovations, the cost of a substantial part of which has been borne totally by coal producers and shippers—not the railroads.

Over this same period, as a result of a number of factors, the domestic and foreign markets for United States coal have not developed as projected. This has primarily been a function of the delivered price of coal. Most recently this has led to coal and power imports making inroads into U.S. markets. In spite of the intense price competition, in both coal markets and alternative energy markets, and in spite of increased efficiencies in moving coal, the price dictated by the railroads for moving coal has continued to rise while the price of coal continues to decline as a result of increased competition and the utilization of enhanced technologies for mining coal. With the exception of CONRAIL and the limited areas where intramodal and intermodal competition exist, the major railroads have steadfastly refused to lower rail rates in response to the increasingly competitive pressures in the markets for coal and the products of coal combustion.

Why have the railroads not responded to the generally accepted principles of supply and demand? Basically the major railroads have found it more profitable to ship less coal with a higher profit margin than to ship more coal at a lower profit margin. This type of pricing policy can only be used in the presence of inelastic demand or supply. In the case of railroads and coal, the supply of transportation is inelastic and the railroads have responded as a monopolist operating without competition.

The plight of the coal industry was well expressed by Interior Secretary, Don Hodel, who stated, while he was Secretary of Energy:

"Frankly, from my point of view, we need some kind of legislation or some kind of provision—I don't know whether it is coal-slurry or something else—which will cause the railroads to begin to be realistic with the rates they charge for transporting energy . . . They have a monopolistic position and frankly they are gouging the consumers in the United States and are rendering us incapable of expanding our markets in the international arena."

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[1] Dwight Keating is President of Barbour Coal Company, Bridgeport, West Virginia. His statement is submitted on behalf of the Mining and Reclamation Council of America (MARC and the West Virginia Mining and Reclamation Association (WVMRA). Mr. Keating is Co-Chairman of MARC's Government Affairs Committee and Chairman of WVMRA.

Secretary Hodel's remarks are, unfortunately, accurate. In a capitalistic economy, competition is relied upon to assure that goods and services are available at the most efficient price. Absent competition, regulatory oversight has been utilized to assure that prices reflect the cost of the service with a reasonable rate of return. Absent competition or regulatory oversight, a monopolist—as a railroad—will charge a rate which will maximize its rate of return.

In doing so, the railroad is fulfilling the primary purpose of any corporation—to maximize profits and the return to its investors, the shareholders. In the absence of competition or regulatory oversight, they are in an excellent position to do such and, rightfully, should be expected to do no less.

Regretable the coal industry is not so fortunate. Over 2,500 coal companies operate in the United States. The 50 largest coal producers only account for roughly 50 percent of the nation's coal production. Hundreds of smaller operators assure that no company will be without competition. By contrast, 4 railroads account for 82 percent of all coal movements by rail in the United States. Nationally, approximately 70 percent of coal transportation is by rail.

In the West, 98 percent of coal production is captive to rail for movement. Nationally, 85 percent of coal movements are capitive to rail. From 1971 to 1982 the amount of coal for domestic use and export shipped by rail increased from 360 to 527 million tons. Over that period, rail revenues for coal movements rose 372 percent while revenues for the coal industry advanced only 85 percent.

A goal of the Staggers Act, which the coal industry supported, was to provide for the revenue adequacy of the railroads to assure a safe and reliable national rail transportation system. As evidenced by the acquisitions and tender offers of the major coal hauling railroads [2] over the past several years, although these carriers are all revenue inadequate and will continue to be such under ICC guidelines, to the public at large they are very revenue adequate. These carriers have internally financed these acquisitions while still being able to make substantial investments in rail facilities which has resulted in significant improvements in rail service and reliability. Additionally, the capital expenditure plans of the railroads underscore their continuing commitment to reliable rail service for coal movement. The coal industry has, as a reuslt, been a direct beneficiary of the Staggers Act. The coal industry's complaint is that it is being forced to pay rates which are far in excess of what is needed for the railroads to continue to make capital improvements and to achieve a market based concept of revenue adequacy.

In addition to revenue adequacy, the other major purpose of the Staggers Act was to provide continuing protection for captive shippers, as coal. The ICC has totally ignored this mandate of the law and progress on a number of other national policies as energy independence, expanded exports, and controling inflation have been hindered as a result.

The Staggers Rail Act was intended by Congress to reform railroad regulation by allowing railroads greater felxibility in setting prices and reducing costs where transportation competition exists while continuing vital protection for captive shippers against abuses in rates and service arising from the exercise of monopoly power by the railroads. The Act also sought to promote rail-to-rail competition. The ICC has emasculated the Staggers Act beyond the possibility of internal administrative correction or the ability of the courts to remedy the ICC's statutory interpretation within their limited purview of review of the ICC's expertise.

A particular concern of MARC arising from the ICC's abrogation of the captive shipper protections of the Staggers Act is the impact on smaller operators. Although all coal producers have relatively little power in negotiating rates with a rail carrier, the smaller operator has no leverage whatsoever. Larger operators, with long term sales contracts and production levels and topographical features that permit the utilization of unit trains, are attractive customers to railroads seeking to sign a contract to secure a steady source of business over a number of years. By contrast, the smaller operator generally is selling on the spot market and does not have sufficient capacity to utilize unit trains. As a consequence, he must accept whatever rate and service terms are prescribed by the carrier since he has no basis to negotiate a contract.

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[2] CSX, Norfolk Southern, Burlington Northern, and CONRAIL control 82 percent of all rail movement of coal.

Prior to the ICC decisions of the past several years, the smaller operator could file a complaint with the ICC if a rate was unreasonable or abusive. As a result of the ICC's decisions in rail market dominance and coal rate guidelines, that leverage—which was a subtle constraint on the railarods—has been effectively taken away.

RECOMMENDATION

For the reasons outlined above MARC and WVMRA consider legislative action imperative to asure that the ICC fulfills the balanced twin goals of the Staggers Act—elimination of unnecessary regulation and the continuance of protection to captive shippers.

Among the critical subjects that must be considered in such legislation are Congressionally mandated:

Standards for maximum reasonable rail rates for captive shippers;
Standards for determination of railroad revenue adequacy;
Standards for determination of railroad market dominance;
Protection against exemption of market dominant traffic from regulation; and,
Protection against anti-competitive rail actions such as cancellation of through routes, joint rates and reciprocal switching agreements.

These issues are addressed in legislation, S. 477 sponsored by Senators Long, Ford, Andrews, Rockefeller, and Stevens and others. MARC and WVMRA strongly support S. 477 and urges the committee to give it prompt consideration.

STATEMENT OF BARBARA WARNER, VICE PRESIDENT, UNITED SMALL COAL OPERATORS

I am Barbara Warner, President of BRJ, Inc. In Bridgeport, West Virginia, and Vice President of United Small Coal Operators of West Virginia. I buy and sell coal from small producers in north central West Virginia. My company processes and loads the coal into Unit Trains at my siding in Clarksburg, West Virginia. In short, I operate an independent rail facility, and I assist small coal producers in marketing and shipping their coal.

I formed BRJ seven years ago after the death of my husband. I have been around the coal business all my life. My grandfather, father and husband were all in the coal business. Though I had never been involved directly in the business myself, I've always loved a challenge, so I decided to take the big step and form my own company.

Last year my company handled 500,000 tons of coal, our best estimate this year is less than 200,000 tons, less than half. We are totally captive to the B & O Railroad. In January, 1985, I talked with Governor Arch Moore, who suggested that the small operators join together to give us a voiced similar to that of the large producers. We formed the United Small Coal Operators in January. In 9 months, our membership has really grown. Recently, some producers from Kentucky and Virginia joined as well.

Let me make this clear: I am not in favor of reregulation. I have, in the coal business lived by the rule of supply and demand, or good competition. I have no idea of the percentage of coal that is shipped under so-called captive situations in the country, or in my state, but I do know that all of the coal shipped out of the central area of West Virginia is captive to a single railroad. When our customers want their coal delivered by rail, it has to be on the B&O.

I feel the problem lies with the ICC and their definition of "Captive Shipper". The Railroads have capitalized on this. There is no way that we can win with the guidelines set by the ICC.

In a free enterprise country, such as ours, it's a shame that the Railroad and Utilities are allowed to make such huge profits, while the small operator, with his lifes' earning invested, is lucky to make any profit, most don't even break even. It is time that the producers join the utilities into forcing down shipping rates, because if we are forced out of business, the utilities will be forced into the monopoly of depending on large producers. This will eventually increase all our costs.

The rates into our local utilities have increased 100% over the last five years, and the cost reductions the railroads have enjoyed have been put in their own pockets to invest in other segments of business instead of trying to arrange a system whereby the profitless coal producers can realize some of the savings. This short sighted behavior has driven 13 out of 17 tipples in the Clarksburg area out of business. The Railroads are devastating their own suppliers. Yet they, themselves own and market a great many coal producing land and business. The railroads have not been attentive or aggressive at this time of depressed prices in the coal economy. It seems at times that they do not want the coal business for a customer. Foreign coal imports will soon impact disastrously on our markets, I feel that quick action should be taken to nip this in the bud. Quite often, utilities are test-burning foreign coal. Why not reduce their cost to a point that they would not be interested in foreign coal, thereby increasing the Railroads business?

Instead of trying to help the producer, the railroads have at a time of depressed prices, decided to tighten the screws. Let me talk about my situation. The B&O Railroad has recently decreased the time allowed to load a unit train from 48 hours to 24 hours and it must be loaded at one point instead of two. If we don't meet this new standard, we must pay the single car rates, which are much higher. To meet these new standards, we must make new investments in coal loading facilities. This causes huge expenditures for the coal producers at a time when the producers have a very small profit margin or more commonly, virtually no profit at all.

The cost for my company to make these investments will be $800,000. When I asked that some of the Railroad cost savings through their new investments be shared with me in the form of lower Unit Train rates, I was told by CSX that any reduction would only help the electric utility and lower the utility's costs. But I need the rate reduced to make our own costs lower and make our coal marketable in the northeastern United States. It is not marketable now!!!

When I met with the U.S. Department of Transportation (DOT) I was told there was a real possibility that the line I am on, the Weston to Clarksburg line would be abandoned in the next three years. When I asked CSX to put in writing assurance that this line would be kept open until I had had sufficient time to recoup my investment, I was told they would not do this. If anything was written, the CSX official said it would have to include a lot of "ifs to protect us".

Until 1985, there was approximately two million tons a year being shipped out of the Clarksburg District.

The economy of West Viginia depends on the shipping of our resources. Captivity to the B&O will destine us to be a welfare state. I went to CSX and asked them for some temporary relief on unit train rates to try to capture a new market, or one we had lost due to Conrail's drastic cuts on unit train rates. Instead, CSX issued a press release on August 19th, offering rate reductions of an average of between $3.50 and $4.50 per ton on single car shipments on B&O direct movements for steam coal in to the Northeast via Conrail destinations. For the record I submit a copy of the new reduced rates from the Clarksburg district.

However, this announcement in fact does not help the small opperator at all. At a meeting of small coal operators on August 21st, I asked if any of the nearly 200 members present could benefit by this new rate reduction. No one responded affirmatively. I, in fact, was the last in our area to ship a single-car load of coal and that was in mid-1984. If they can reduce single car rates by $4.50 per ton they can reduce Unit Train rates as well.

We could become competitive in the Northeast markets and export markets if they would lower the Unit Train rates by 2 or 3 dollars per ton. The Railroad's are actually the ones who market our coal by the rates they set to haul it.

Railroad costs are decreasing daily. Have any of these savings been handed back to the shippers? No! As their bank accounts grow, our's are depleted by the demands that they put on us.

So we have a problem. The Railroads want us to make investments that help the railroads save money. But they won't share any of those savings with us. Their rates are hurting us. We need help!!!

Let's put everyone on equal footing. If changes in the Staggers Act are needed, let's do it. If an attitude adjustment is neccessary for the ICC, let's convince them. If trackage rights legislation is needed, let's move on it. If the railroads had good competition to prod them on, it would be amazing to see the changes made—and promptly.

In lieu of a major change in the "Staggers Act" change the interpretation and use the intent of Congress when the act was passed. The major thrust must be the "ICC" allowance of the rate application.

STATEMENT OF DAVID C. BASTRESS, VICE PRESIDENT—TRANSPORTATION, LINCOLN GRAIN, INC.

Lincoln Grain is a regional grain handling and merchandising company doing business in Kansas and Nebraska. Lincoln Grain handles, stores, and transports grain for hundreds of farmers, country elevators, feeders, millers, and consumers, and is a supplier to all major exporters, and to a multitude of domestic users. We also operate a dry corn mill in Atchison, Kansas. These are our comments for the

Staggers Oversight Hearings before the Senate Subcommittee on Surface Transportation to be held on November 4, 1985.

The only real and measurable victory for the American farmer since the 1980 embargo has been railroad deregulation as embodied in the Staggers Act. It has, simply stated, brought the grain farmer closer to market in terms of lower transportation costs and therefore increased farm grain prices.

A new, detailed and comprehensive study entitled "Impacts of Rail Deregulation on Marketing of Kansas Wheat," was released in September of 1985 by the U.S.D.A.'s Office of Transportation and Kansas State University.

Briefly, the study revealed that contract rates contributed to declining rates for shipping wheat in the state of Kansas. The study showed that farmers benefited from lower shipping costs through potentially higher grain prices at local markets. "Impacts of rail initiatives on Kansas farmers are through higher prices for grain entering commercial markets," said the report.

The study indicated that rates of the Gulf of Mexico from Kansas increased and aveage of 64 percent from 1977 to 1981, but dropped 34 percent after the Staggers Act was enacted. "As a result, farmers have benefited from reduced rail rates and many small shippers have adjusted well to the new environment," the study said.

In spite of emerging scholarship such as the Kansas State study, some controversy still surrounds the act. You have heard today from certain of those still bent on reshapping the act for their own purposes. It should not escape the committee, however, that this victory for the farmer was won with marches on Washington, tractorcades, or publicity blitzes. It was quietly achieved by rail carrriers, competent grain handlers and, yes, the I.C.C. shaping a better futture out of a piece of legislation which was designed to allow all of them to do so.

Much of the remaining controversy on Staggers Act in the grain trade focuses on contracts. But there is a quiet aspect of contracts which the protestors ignore . . . railroads not grain shippers are competing.

Since Staggers, each railroad is attempting to draw traffic to their line. Every railroad has to and does consider, to the best of their ability, what other railroads are doing or might do. Because of confidential contracts, they can never be exactly sure. They are the ones who are really competing. Confidential contracts keep railroads on their best behavior with the result that every railroad must, and does keep their best grain rates forward at every location every day. The fact that farmers are mobile in their grain deliveries and can find, and deliver to the best market on any given day, is part of the "Keep them honest" equation. There will probably always be some grain handler somewhere who prefers less than full competition. But the railroad competition which results from confidential contracts in their present form carries a broad public and farmer benefit. This broad benefit should not be obscured or neglected when measuring any narrow aspects on rules for disclosure.

Localized or narrow constituency fringe groups will probably continue to batter both the House and the Senate with their "better" versions of several contrived Staggers Act Issues that are unsupported by facts. Wise legislators will look beyond such versions to the bottom line. . . . Something has been done for the American farmer without a raid on the Federal Treasury.

STATEMENT OF EDISON ELECTRIC INSTITUTE

INTRODUCTION

The members of the Edison Electric Institute (EEI) appreciate the opportunity to submit this statement to address in some detail the impact of railroad transportation rates on the principal shippers and users of coal, and the millions of consumers they serve.

EEI is the association of investor-owned electric utilities. Our members served 96% of all customers served by the investor-owned segment of the industry. They generate approximately 75% of all the electricity used in this country and they serve, through either retail or wholesale electricity sales, 73% of all U.S. electric customers.

Each of our nation's investor-owned utilities, all of which are subject to public service commission regulation, is under an affirmative obligation to purchase the least expensive reliable source of fuel that is available. We are under an obligation to try to minimize the cost of electricity to our customers. Thus, for a utility and its customers, the cost of coal delivered to our generating facilities is a very important cost. This cost is composed of both the minemouth price of the coal, which we pay to the coal producer pursuant to a coal purchase contract, and the cost of transporting the coal to our facilities, which we pay to railroads pursuant to either a tariff rate or a contract entered into between the utility and the railroad. In some cases, of course, coal is delivered from mine to utility by a transportation mode other than rail.

The total delivered cost of our coal is paid by the ratepayers either through a fuel cost adjustment clause billing component or as a cost recovery element in base rates. Public service commissions do not allow utilities to make a profit on fuel costs.

Our message has as its foundation the critical relationship between the nation's railroads and U.S. coal-burning utilities. This relationship is complicated by the fact that many coal shippers and users have no alternative to coal hauling service by a single railroad—they are what Congress, in deliberations leading to enactment of the Staggers Rail Act of 1980, referred to as "captive shippers." Because the marketplace provides no protection for such shippers, the Staggers Act provides that the Interstate Commerce Commission (ICC) shall assure that the railroad rates charged such shippers are "reasonable". Through the adoption of a series of bad policies, the ICC has rendered virtually meaningless the Staggers Act "captive shipper" protections. In fact, since enactment of the Staggers Act, no coal shipper has won a rail rate case.[1]

The relationship between coal users, consumers and the railroads is out of balance. When the marketplace forces the railroads to make wise and moderate pricing decisions, no harm is done. When the railroads possess monopoly power and make bad pricing judgments, or perceive their interests to be different from those of their customers, then neither the marketplace nor the present ICC regulatory system provides protection for coal shippers and their customers. We believe that Congress must act to put the ICC system back in balance by assuring that the captive shipper protections in the Staggers Act are implemented properly.

THE RAILROADS' POWER OVER UTILITY COAL TRAFFIC

Two facts must be kept firmly in mind as one examines the respective experiences of railroads and rail shippers under the ICC's regulatory policies over the past five years: (1) coal is the bread-and-butter commodity for the major U.S. railroads; and (2) electric utilities are by far the largest buyers and users of coal. This critical link between railroads and utilities provides the backdrop against which any serious discussion of rail regulatory policy must take place.

In 1984, electric utilities purchased over 700 million tons of coal, some 78% of the coal produced in the United States that year. Of this amount, almost two-thirds—460 million tons—was transported to power plants by rail. Electric utilities incur approximately $5.5 billion in rail freight charges each year, representing, on average, 35% of the total delivered cost of coal for power generation.[2] These rail freight charges are paid by the utilities' ratepayers.

The numbers are staggering from the railroads' side as well. Data developed by the ICC shows that coal ranks highest among the commodities carried by rail in terms of tonnage.[3] Since 1976, while the aggregate volume of all other commodities has declined, coal tonnage has risen steadily and significantly.

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[1] The AAR has indicated that there have been three cases since the Staggers Act was enacted in which rail rates have been found unreasonable by the ICC. The three cases are Docket No. 37276 (Sub-No. 1), *Coal, Wyoming to Redfield, Arkansas;* Docket No. 37409, *Aggregate Volume Rate On Coal, Acco, Utah to Moapa, Nevada;* and No. 38566, *Rates on Iron Ore To Escanaba, MI, Chicago and Northwestern.* None of these cases have yet reached a final decision. Two of them, the *Redfield* and the *Moapa* cases, were recalled from court appeals by the ICC on the grounds that they had been decided on pre-Staggers Act principles which were no longer valid. Both of these cases were recently reopened by the ICC for further consideration under the recently issued Coal Rate Guidelines. Although in both of these cases the ICC did find the challenged rates to be unreasonable, only in the *Redfield* case was the rate actually reduced, in the amount of 12 cents per ton. Seventeen months later the rate was increased once again. Reparations for past overcharges were also awarded in the *Redfield* case, but have never been paid by the railroad.

The *Escanaba* case, involving rates on iron ore, was decided on the basis that the rate increase being challenged was in violation of a letter agreement between the shipper and the railroad. The syllabus of the ICC's printed decision indicates that its action in that case was to "enforce" a "contract" rate. Thus, this case was not decided in the traditional maximum rate reasonableness context.

[2] Actually, in many cases the cost of transportation as a percentage of delivered fuel cost is much higher, sometimes as high as 80%.

[3] In 1981 coal accounted for 34% of all tonnage. Source: "1981 Carload Waybill Statistics: Territorial Distribution, Traffic and Revenue by Commodity Classes," U.S. Department of Transportation (Statement TD-1), Federal Railroad Administration, Office of Finance and Operations.

Coal also provides the railroads with the most profit of any commodity. Because most shipments move in highly efficient unit train and trainload hauls, variable costs of service per ton-mile [4] are less than half those of other commodities (43%), according to an EEI study [5] based upon data contained in the 1981 ICC One Percent Waybill Sample (the latest reliable date available according to the ICC).[6] As a result, while the average operating margin of profit over costs for all commodities is 22%, the margin doubles to 44% for coal.[7]

Coal's profitability to the railroads is directly attributable to its status as a commodity that is largely captive to rail service. Because of the volumes and distances involved, as well as the location of mines and power plants far from navigable waterways, railroads in general face little competition from motor or water carriers in hauling coal to many utilities. Potentially competitive technology exists in the form of coal slurry pipelines, but extensive railroad land holdings and rights of way and the absence of federal eminent domain authority (due largely to railraod lobbying efforts) have combined to keep coal pipelines on the drawing board and out of the transportation market. Finally, boiler design specifications and environmental and energy use regulations effectively preclude the substitution of oil or gas for coal-fired power, and in many cases even operate to tie a utility to a specific coal source.

A study conducted for the ICC in 1982 [8] concluded that 53% of coal-buring utilities were effectively constrained from accessing competitive sources, railroads or modes in different geographic regions, a situation which was forecast to continue unabated well into the 1990's. A recent EEI survey found that approximately 64% of utility rail coal tonnage is captive to delivery by a single railroad. The EEI coal profitability analysis shows that the average "revenue to variable cost ratio" for coal was approximately 180%. For all other commodities, the average ratio was 128%. This disparity reflects the strong rail market power over coal transportation.[9]

Recently, the ICC indicated its belief that the actual percentage of coal-burning utilities that are rail captive is small; somewhere on the order of 15-20%.[10] This figure is based upon two studies, one conducted by the ICC staff, and the other by the Reebie Associates consulting firm. Both studies, however, rely upon data bases or assumptions which dramatically skew the results, and grossly understate the problem of rail captivity for utility coal shippers.

The ICC study purported to compare railroad revenues from coal with rail service costs in an effort to determine how many coal rates were set at levels in excess of the revenue/cost ratio threshold for ICC jurisdiction—currently 180%. This "study," however, measured rail costs on the basic of total system averages—which reflect costs associated with movements of all sorts of commodities besides coal. Only a few of the adjustments to these costs routinely made and approved by the ICC in rail coal rate cases were made by the staff conducting the study. As already noted, the high degree of efficiency which characterizes utility coal shipments result in unit costs on this traffic that are approximately one-half of the average for all other rail traffic. In failing to make the adjustments typically applied to reflect this efficiency, the staff grossly overstated the relevant costs. The ratios calculated by the ICC—and thus its study results—bear little resemblance to the realities of utility coal shipments.

The Reebie Study is based on several assumptions which essentially "assume away" the captive shipper problem.[11] As acknowledge by the preparers, the Study

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[4] A ton-mile is a measuring unit which describes the movement of one ton of traffic one mile.

[5] See "Coal Profitability Relative to Other Commodities," Edison Electric Institute, August, 1985 ("Coal Profitability") at 3.

[6] Although the waybill sample for 1982 is available, as the Commission explained in its January 25, 1985 decision in Ex Parte No. 399, Cost Recovery Percentage, there are certain problems with that analysis. Because of those problems, the ICC relied on the 1981 waybill sample in Ex Parte No. 399, at 3.

[7] Coal Profitability, supra, at 3. Operating margin of profit is the difference between revenues and variable cost divided by revenues. This term is used since variable cost, as tetermined by the ICC, includes elements of what are generally considered to be fixed costs for most industries.

[8] "An Analysis of Source or Geographic Competition for the Delivery of Steam Coal to Utilities," Contract No. ICC-82-M-1731-D, July 26, 1982.

[9] Courts in antitrust cases have consistently held that the best indicator of market power is a firm's ability to set and maintain prices at supra-competitive levels. See, e.g., *United States* v. *E.I. duPont De Nemours & Co.*, 351 U.S. 377 (1956); *United States* v. *Grinnell Corp.*, 384 U.S. 563 (1966).

[10] Ex Parte No. 347 (Sub-No.1), Coal Rate Guidelines—Nationwide, Decision served September 3, 1985 at 3.

[11] "Coal-Fired Utilities Dependency on Rail Carriers as a Transport Delivery Mode," Reebie Associates, September 27, 1984.

(a) did not take into account the existence of long-term coal supply contracts binding coal users to specific sources; (b) did not take environmental limitations on coal quality into account; (c) did not consider existing legal and/or social barriers to new railroad entry or existing railroad expansion; and (d) assumed that the Commission would make aggressive use of its power to order reciprocal switching or terminal trackage rights wherever necessary to permit alternative railroad access to coal sources and power plants. Having "assumed away" virtually all of the major impediments to expanded competitive access which exist in actual practice, it is a small wonder that the Rebbie Study was able to label a relatively small (13%) portion of utility coal shipments "truly captive."

Regardless of what the precise percentage of captive utility coal shippers may be, the reality is that many coal shipments for electric power generation are captive to individual railroads. This railroad market power rates on these shipments particularly susceptible to abuse, a point clearly recognized by Congress in the Staggers Rail Act of 1980 when it called for a balanced approach to rail regulation and created special statutory protections for captive shippers. However, the experience since 1980 has been marked by repeated failures on the part of the ICC to strike the proper balance. It is for this reason, and out of the frustration borne by captive shippers under the current regulatory regime, that we seek Congressional action.

THE ICC'S IMPLEMENTATION OF THE STAGGERS ACT HAS PREVENTED CAPTIVE COAL SHIPPERS FROM RECEIVING THE EQUITABLE TREATMENT CONGRESS INTENDED

Everyone who participated in the long and sometimes arduous legislative effort that went into the Staggers Rail Act of 1980 recognized that the final legislation represented a compromise of competing interests. The central compromise that made Staggers possible was in the area of rail rates. Congress recognized that railroads needed the opportunity to generate sufficient revenues to achieve financial stability. Congress also recognized that captive rail shippers in general, and captive coal shippers in particular, should not be forced to pay excessive freight rates to railroads. In crafting the Staggers Act, Congress carefully sought to balance these two policy concerns. However, in implementing the Staggers Rail Act, the ICC has undermined the legislative balance built into this law by its decisions in a series of rulemaking proceedings which have ignored, eliminated, or severely curtailed the protections Congress sought to accord captive coal shippers.

Congressional Concern For Captive Shippers

Congress adopted as a Staggers Act policy goal: "to provide a regulatory process that balances the needs of railroads, shippers, and the public." [12] Insofar as rail ratemaking was concerned, Congress stated that the ICC should act "to foster sound economic conditions in transportation" while, at the same time, act "to maintain reasonable rates where there is an absence of effective competition." [13]

Maintenance of fair transportation rates on coal traffic was of particular concern to Congress. Congress considered coal traffic to be the prime example of a commodity over which railroads possess market dominance, and cautioned that railroads should not be permitted to meet a disproportionate share of their revenue needs by charging excessive rates on coal traffic. As stated by the Senate Commerce Committee concerning its version of the Staggers Act:

> This bill provides continued protection for shippers where such protection is necessary in the public interest. The [Senate] Committee [on Commerce, Science and Transportation] expects this protection to be utilized by the Commission to prevent extensive cross-subsidization or an excessive contribution from captive traffic. *The rates on coal are of particular concern in view of the many substantial increases imposed on this traffic in the last several years.* While recognizing that not all traffic can be transported at a fully allocated cost level due to competitive considerations, it is the Committee's intent that the Commission play an active role in insuring that such traffic bears its fair share of costs and that higher rated captive traffic is not unduly burdened. (Emphasis added).[14]

The Staggers Act Conference Report also emphasized Congress' special concern for coal:

> The Conferees intend that this [rail transportation] policy include the encouragement and promotion of the transportation of coal by rail in accordance with the ob-

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[12] Staggers Rail Act of 1980, P.L. No. 96-448, § 3, 94 Stat. 1895, 1897 (October 14, 1980).

[13] Id. § 101(a), 94 Stat. 1897, codified at 49 U.S.C. § 10101a(5) and (6).

[14] S. Rep. No. 96-470, 96th Cong. 1st Sess. 7 (1979).

jective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition.[15]

Indeed, the Staggers Act was a compromise which passed solely because of assurances built into the structure and policies of the legislation, that regulation would be maintained where marketplace competition was insufficient to protect captive shippers and the public from abusive practices by the railroads. As stated by Congressman Rahall, author of a key compromise amendment which enabled the legislation to pass:

> [M]y involvement in the rail legislation now before the House was to assure that a balance was struck, a balance which would allow carriers to achieve adequate revenues while providing protection for captive shippers against unjustifiably high rail rates. I believe this balance has been struck and urge support for the Conference Report.[16]

The legislative balance of shipper and railroad interests incorporated into the Staggers Act has been acknowledged repeatedly by reviewing courts in post-Staggers Act cases construing the Act.[17] Perhaps the best judicial expression of the balancing of interests that lies at the heart of the Staggers Act was provided in a recent decision by the D.C. Circuit overturning the ICC's decision to deregulate rail transportation of export coal:

> The Staggers Act was not, however, a simple deregulation of the railroad industry. Instead, it was a simultaneous recognition of two conditions. On the one hand, Congress recognized that in large parts of the rail industry heavily regulated rail carriers faced competitive conditions. In many cases these carriers competed with other modes of transportation which were unregulated and therefore able to be more innovative and flexible. Congress found that too often the ICC's regulatory framework had become an unnecessary and crippling burden on the rail industry, and was an impediment to the industry's ability to attract the capital necessary to meet the nation's future needs. On the other hand, Congress recognized that sometimes competition would be insufficient to protect the legitimate interests of shippers, small carriers, and the public, and thus that full deregulation of the industry was unjustified by industry conditions. The legislation that eventually became the Staggers Act was subject to significant modification during floor debate, with many of the successful amendments supported by legislators who feared that the bills that emerged from the committees might not afford adequate protection to shippers where they might otherwise suffer from abuses of market power. The resulting Act was a compromise that enjoyed overwhelming support. Although the legislation was without doubt a significant reduction in railroad regulation, as this court has said, "The legislation * * * did not strip the Commission of its power and duty to protect shippers from the unreasonably high rates of carriers with market dominance." *Burlington Northern Inc.* v. *United States*. 661 F.2d 964, 973 (D.C. Cir. 1981). Both before an after the amendments the bills' sponsors agreed that the underlying approach of the legislation was to move toward much greater reliance on market forces rather than regulation to govern rail carriage, but to temper that move with a policy of retaining regulation where the market would be insufficient to protect shippers and the public from abusive railroad practices.
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> *Coal Exporters Ass'n* v. *United States*, 745 F.2d 76, 81 (D.C. Cir. 1984) (footnotes omitted), cert. denied, 53 U.S.L.W. 3772.

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In short, the text of the Staggers Act and its legislative history emphasize that the ICC must consider and balance the interests of captive coal shippers in its regulatory actions. Despite this clear intent, the ICC has not accomplished the balancing task Congress intended it to pursue.

The ICC's Failure To Protect Captive Coal Shippers

The Staggers Rail Act provides that a captive shipper who is concerned about a railroad rate may petition the Commission to have the reasonableness of the rate adjudicated. Prior ICC approval of rail rates is not required under the Staggers Act.

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[15] H.R. Conf. Rep. No. 96-1430, 96th Cong., 2d Sess. 80 (1980). The importance of coal to Congress is underscored by the fact that the quoted language was the only substantive comment in the Conference Report on the rail transportation policy in section 10101a.

[16] 126 Cong. Rec. H10086-87 (daily ed., Sept. 30, 1980).

[17] See e.g.; *Burlington Northern, Inc.* v. *United States*, 661 F.2d 964, 973, (D.C. Cir. 1981); *Cleveland-Cliffs Iron Co.* v. *ICC*, *664 F.2d 568, 587 (6th Cir. 1981)*; *Iowa Public Service Co.* v. *ICC*, 643 F.2d 542, 548 (8th Cir. 1981); *Union Pacific R.R.* v. *United States*, 637 F.2d 764, 767 (10th Cir. 1981); *Celanese Chemical Co.* v. *United States*, 632 F.2d 568, 577 (5th Cir. 1981) cert. denied *Atchison, Topeka & Santa Fe R. Co.* v. *United States* 453 U.S. 950 1981).

Rather, the railroad establishes the rate by filing a tariff rate for the shipper in question. In certain very limited circumstances, the Commission does have the power to suspend a filed rate prior to its going into effect and start an investigation into its reasonableness, but the ICC has only used this power in very rare circumstances since 1980. As a rule, therefore, if the shipper believes the rate is excessive, the shipper must petition the ICC for relief once the rate has become effective.

The shipper must first prove that it is a "captive shipper" under the terms of the Act by proving (1) that its rate exceeds a jurisdictional threshold and (2) that the shipper is subject to railroad "market dominance". Market dominance means that the shipper has no effective alternative but to ship the commodity in question via the railroad(s) charging the challenged rate. Having proved that it qualifies as a captive shipper, the shipper, not the railroad, must then carry the burden of proof as to the reasonableness or unreasonableness of the rate. Determination of rate unreasonableness involves the "revenue adequacy" test and the "rate reasonableness" test. The proceedings in which the Commission developed these tests, therefore, are pivotal to each individual captive shipper rate case.

Four rulemaking proceedings are particularly illustrative of the ICC's failure to implement congressional intent regarding the protection of captive shippers. Each of these is addressed in turn.

1. The Revenue Adequacy Proceeding (Ex Parte No. 393)[18]

Using standards developed in Ex Parte No. 393, the ICC has determined that every Class I railroad in the United States is "revenue inadequate."[19] In order for the railroad industry to obtain "revenue adequacy" as defined by the ICC, billions of dollars in additional freight revenues must be contributed to the railroad system by shippers.

This situation is devastating to captive shippers because in every case where rail rates are challenged as being unreasonably high, the involved railroads refer to the massive influx of dollars the ICC has declared the railroads need in order to be "revenue adequate" as a justification for charging monopoly rates on captive traffic. Such arguments have been very successful, and the Commission has constantly referred to the need of individual railroads to achieve revenue adequacy as the overriding consideration justifying extremely high rates on captive coal traffic.[20]

The ICC's view of the financial needs and revenue adequacy of the nation's railroads has eliminated the balance between railroad revenue needs and individual rate reasonableness requirements which Congress sought to foster in the Staggers Act. In order to fully understand this problem, it is necessary first to understand why the concept of "revenue adequacy" is so crucial to the correct working of the Staggers Act; to understand the key errors in the ICC's decision in Ex Parte No. 393; and finally to understand the substantial public criticism of the ICC's misguided standards.

(a) The Importance of the Revenue Adequacy Concept in the Staggers Act

The Staggers Act retained the "revenue adequacy" standards initially set forth in the Railroad Revitalization and Regulatory Reform Act of 1976.[21] Pursuant to these 4-R Act provisions, the ICC is called upon to analyze relevant railroad financial data to determine which railroads are financially sound or "revenue adequate" and which railroads are not financially sound, i.e. those which were found to be "revenue inadequate." In 1978, the ICC established regulatory standards and procedures for measuring railroad revenue adequacy.[22] In this decision, the ICC determined that it would look at "all pertinent financial indicators" to judge the financial strength and revenue posture of individual railroads. Using this approach, the ICC found in 1979 that 11 of the 31 Class I railroads enjoyed adequate revenues based upon data for calendar years 1975 through 1977.[23]

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[18] Ex Parte No. 393, Standards for Railroad Revenue Adequacy, 45 Fed. Reg. 80150 (Dec. 3, 1980) (Notice of Proposed Rulemaking); 364 I.C.C. 803 (1981) (final decision).

[19] See e.g., Ex Parte No. 457, Railroad Revenue Adequacy—1983 Determination (Decision served Jan. 4, 1985) ("the Commission has now determined that none of the 32 Class I carriers are revenue adequate." *Id.* at Sheet 1).

[20] See e.g., *Potomac Electric Power Co.* v. *Consolidated Rail Corp.*, 367 I.C.C. 532, 537. The ICC's specific rail rate reasonableness policies are discussed later in this statement, but it must be noted from the outset that the Commission's views concerning railroad revenue adequacy lie at the heart of its rate reasonableness policies.

[21] Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31 (1976) (hereinafter cited as "4-R Act"), and currently codified at 49 U.S.C. § 10704(a)(2).

[22] Ex Parte No. 338, Standards and Procedures for the Establishment of Adequate Revenue Levels, 358 I.C.C. 844, modified, 359 I.C.C. 270 (1978).

[23] Ex Parte No. 353, Adequacy of Railroad Revenue (1978 Determination), 362 I.C.C. 198 (1979).

Despite urgings from the Nation's railroads during the Staggers Act debate that the Commission was improperly measuring railroad revenue adequacy, Congress refused to change the definition of revenue adequacy set forth in the 4-R Act. Congress did, however, direct the ICC to make revenue adequacy determinations each year.[24]

The Staggers Act also made structural changes in the Interstate Commerce Act designed to give revenue inadequate railroads greater rate freedoms than revenue adequate railroads. Thus, Congress specifically required that the ICC consider its revenue adequacy findings in individual rate cases (Staggers Act § 201, 94 Stat. 1899); required the ICC to give "due consideration" to a railroad's revenue adequacy status in determining whether the railroad could use the 6% zone of rate flexibility applicable from October 1, 1980 through October 1, 1984 (*id.* § 203(a), 94 Stat. 1903); [25] precluded revenue adequate railroads from using the rate freedoms under the 4% rate flexibility zone commencing in October 1, 1984 (id. § 203(a), 94 Stat. 1902); and required the Commission to take into account the revenue adequacy of a railroad in connection with the rate surcharge provisions set forth in Section 217 of the Staggers Act.[26] As a result, revenue adequacy determinations may directly affect rates to captive shippers, but should have no effect upon rates for shippers with competitive alternatives. For this reason, the regulation function of the revenue adequacy determination is comparable to the function utility regulatory commissions accomplish when identifying revenue requirements for the companies they regulate.

Given the contexts in which the revenue adequacy concept is employed in the Staggers Act and in the ICC's decisions construing that Act, it is of fundamental importance that the standards used to determine a railroad's revenue adequacy comport with financial reality. To the extent that the ICC declares to be revenue inadequate when in reality it is not, the entire structure of the ratemaking provisions in the Staggers Act is completely skewed. This is precisely what has happened through the ICC's Ex Parte No. 383 decision.

(b) The Commission's Ex Parte No. 393 Decision

Soon after the Staggers Act was passed, the ICC initiated a rulemaking proceeding for purposes of "revising" the standards it had previously used for purposes of making revenue adequacy determinations. In this proceeding the Commission decided to determine rail revenue adequacy based solely upon a railroad's return on its net investment base.[27]

Using this criterion, the Commission has determined that none of the nation's Class I railroads are "revenue adequate" and that the "revenue shortfall" (the difference between the amounts of money the railroads need to receive to be revenue adequate and the amount they currently are receiving) amounts to several billion dollars.[28]

While the ICC revenue adequacy standards use financial terminology similar to that used by the financial community and other regulatory agencies in evaluating, for example, the financial health of electric utilities, the actual regulatory precepts used are far different from those generally applied to regulated utilities—and electric utilities in particular. As stated by Dr. Wesley H. Long, District of Columbia Public Service Commissioner and Chairman of the National Association of Regulatory Utility Commissioners' (NARUC) Subcommittee on the Staggers Act Implementation:

> The ICC's methods result in overstated costs and understated returns on the railroads' investment. The end result is that rail freight customers, especially those,

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[24] Staggers Act § 205(b)(2), 94 Stat. 1906, codified at 49 U.S.C. § 10704(a) (3), (4).

[25] Under Section 203(a) of the Act (codified at 49 U.S.C. § 10707a (c) and (d)), Congress established "zones of flexibility" with respect to rates. Between October 1, 1980 and September 30, 1984, railroads were permitted to take annual rate increases of up to 6%, after inflation. As of October 1, 1984, the flexibility zone was reduced to 4% per year, and is only available to revenue inadequate carriers. Rate increases within the zone cannot be suspended by the ICC prior to their effectiveness, and can only be investigated on the Commission's own initiative under limited circumstances. A shipper, however, can still file a complaint challenging the reasonableness of a rate as augmented by an increase within the flexibility zone.

[26] Section 217 of the Act gave railroad parties to joint rates the power to impose unilateral surcharges on their portion of the joint rate without the necessary concurrence of other connecting carriers. This mechanism was designed to allow railroads with disproportionately low shares of joint rates to increase their revenue without having to convince the other participants to either raise the entire rate or reduce their own shares. The surcharge power expired on October 1, 1984.

[27] Ex Parte No. 393, Standards for Railroad Revenue Adequacy, 364 I.C.C. 803 (1981).

[28] Ex Parte No. 457, supra, note 1.

such as coal shippers, having no other practical means to transport their freight, are burdened with excessive transportation costs. Such costs are passed on to the consuming public in the form of higher rates for electricity and other goods or commodities.

The ICC substantially increases railroad revenue adequacy requirements in a number of ways. For example, in making revenue adequacy determinations the ICC:

Includes the current market cost of debt rather than the generally lower contractual cost of debt which the railroads actually pay;

Permits the railroads to earn a return on deferred taxes as part of their investment base. Although these funds are acquired without cost to the railroads, they are treated as though costs were incurred. The result is that railroad revenue adequacy requirements are increased;

Determines railroad debt-equity ratios on the basis of current market rather than actually incurred costs and makes no judgment as to the prudence of the railroads' capital structure; and

Fails, by its own admission, to include all railroad related investments, revenues and expenses in the determination.

In the words of an ICC Administrative Law Judge: "Using the present method of arriving at a finding as to which carriers are revenue adequate it will be difficult if not impossible for any carrier to be considered revenue adequate."[29] In essence, the methodology for measuring railroad financial health as defined by the ICC is unique and not consistent with methods applied by other utility regulatory commissions.

If practices generally applied by utility regulatory commissions were used, a far more realistic view of the railroads' economic health would emerge. Under the current ICC standards, these railroads will continue to fall far short of revenue adequacy for years to come.

(c) Public acknowledgement of the ICC's revenue adequacy errors

Perhaps the best example of the problem with the ICC's current revenue adequacy standards involves the Norfolk Southern Corporation. The Norfolk Southern controls the Norfolk & Western and Southern Railways, from which it derives approximately 90% of its revenues. Both of these railroads have been determined to be revenue inadequate by the ICC because their "rates of return" on net investment, as calculated by the ICC in their most recent determination, are less than 5.4%—substantially below the 15.3% return the ICC has established as the minimum needed to achieve revenue adequacy. However, the Department of Transportation has chosen the Norfolk Southern as its candidate to purchase Conrail—at a cost of $1.2 billion—specifically because of its vibrant financial health and prospects for long-term profitability.

It is clear that the ICC's standards for determining railroad revenue adequacy are improper. The standards significantly overstate the sums of money that railroads need to be revenue adequate. Because of the importance of the revenue adequacy concept in the overall construction of the Staggers Act, the ICC's flawed implementation of this statutory standard has undercut the entire statutory scheme.

(d) Proposed revisions to revenue adequacy standards

The ICC now has under consideration new revenue adequacy standards which it proposed in 1983.[30] Rather than making the ICC's approach more consistent with that of other regulatory agencies, however, these proposed new standards would obscure railroad financial health even further. The most consequential of the new proposals would value the railroads' investment base on the basis of current cost rather than original cost. (It is unclear whether the ICC would apply reproduction or replacement cost.) Adoption of this methodology would by itself increase the railroad industry's revenue "needs" very substantially.

2. The Coal Rate Guidelines Proceeding, (Ex Parte No. 347 (Sub-No. 1)[31]

The Coal Rate Guidelines proceeding was begun in 1978 to establish ratemaking standards to apply in individual coal rate cases at the ICC. The final guidelines were issued in this proceeding on September 3, 1985—some seven years after the proceeding was initiated. During this seven year period, numerous individual rate cases were heard by the ICC, which were decided using various "interim" ratemaking standards. Significantly, since the passage of the Staggers Act in 1980 no coal shipper has realized a permanent reduction in its rail rate.[32]

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[29] No. 37854S, *Consumers Power Company* v. *Norfolk & Western Ry. Co.*, Decision served January 18, 1984.

[30] Ex Parte No. 393 (Sub-No. 1), *Standards For Railroad Revenue Adequacy*, Decision served March 9, 1983.

[31] Commenced as Ex Parte No. 347, *Western Coal Investigation—Guidelines for Railroad Rate Structure* (notice served May 11, 1978); Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines—Nationwide* (Decision served Sept. 3, 1985) (Final decision).

Indeed, rate case adjudication before the ICC is so one-sided (*i.e.*, the shipper loses) that one of the ICC's Administrative Law Judges (ALJ) took the extraordinary action, in a published opinion, of telling shippers not to bring cases before the ICC because, regardless of the merits of the shipper's case, the ICC would never grant any relief to shippers. As stated by ALJ Hopkins:

> While it might again be tilting at windmills, it appears to this Administrative Law Judge that the complainants are wasting an enormous amount of time, energy and money, proceeding with these cases before a Commission that has clearly shown that it is unable or unwilling to find a complained of rail rate to be above a maximum reasonable level where a carrier is not revenue adequate. The question as to what aspects go into deciding revenue adequacy is another matter. The Staggers Act as presently construed, even though on an interim basis, without Congressional changes and with a Commission as presently constituted, leaves no hope for complainant shippers.[33]

While the Commission's new Coal Rate Guideline purport to balance the interests of railroads, shippers and the general public, they do not provide meaningful protection for captive shippers as required by the Staggers Act. The ICC has adopted what it terms the "constrained market pricing methodology." This methodology contains four purported "constraints" on railroad pricing of captive traffic: the Stand-Alone Cost Constraint, the Revenue Adequacy Constraint, the Management Efficiency Constraint, and the Phase-in Constraint. An analysis of each of these constraints and their principal defects follows.

(a) The Stand-Alone Cost Constraint

Under this "constraint," a shipper must prove that a rate is unreasonable by proving that it is higher than the cost the shipper would have to pay to provide the same service itself, or to obtain the same service from a hypothetical alternative transportation source. Since a stand-alone railroad hauling only the traffic of the complaining shipper will be astronomically expensive, a shipper first will have to analyze what other traffic also could be carried by the stand-alone railroad. Next, it will have to determine what rail plant (land for right-of-way, rails, ties, bridges, road crossings, maintenance facilities, signalling systems, etc.) and equipment (locomotives, cars, maintenance equipment, etc.) would be required to handle the defined traffic base. In order to make this determination, it also will be necessary for the shipper to work out an operating plan and define the labor force for the stand-alone railroad, since the manner of operation will dictate other requirements. For example, the amount of rail maintenance equipment required will depend upon the number of maintenance districts the stand-alone railroad will have and the number of maintenance employees in each district.

Once the operating plan, labor force, railroad plant and equipment requirements for the theoretical railroad have been established, the shipper must then demonstrate what the cost of this entire enterprise would be. The final step would be for the shipper to show what portion of the cost of the stand-alone railroad should be borne by each segment of the traffic it would carry. All of this analysis must be conducted on the wholly theoretical proposition that a stand alone transportation alternative could somehow be possible, although in the real world numerous factors may rule out construction of alternative transportation systems regardless of economic considerations. Operating on this theoretical level necessarily entails tremendous uncertainty and speculation and presents fertile ground for dispute between the parties in a context where "real" facts may provide the Commission little basis for resolving issues.

The shipper bears the burden of proof with regard to each and every element of this exercise of establishing the traffic base, plant and equipment requirements, operating parameters and labor requirements, costs and demand-based rate structure for the mythical stand-alone railroad. If the Commission should find that the rate which the shipper's traffic would have to pay to move on the stand-alone railroad is less than the rate being challenged, the decision states that "we will take whatever action is appropriate, based upon the nature and extent of the violation shown, to afford relief to the complaining shipper and to promote proper pricing by the carrier." [34]

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[32] In a very few instances, an initial determination of unreasonableness has been made by an ALJ. In each, however, either the filing of an appeal by the railroads followed by an ICC order to hold the case in abeyance, or some other development has prevented the ALJ order from ever taking effect.

[33] Docket No. 378538, *Consumers Power Co.* v. *Missouri Pacific Railroad Co.*, Decision served Jan. 18, 1984, at 8.

In order to make the detailed evidentiary showings required to attempt to satisfy the requirements for a stand-alone cost analysis, a shipper must retain witnesses with expertise in at least the following areas: railway engineering, signalling systems, train operations, equipment maintenance, maintenance-of-way, railroad accounting, economics, and costing, as well as specialized counsel. This team of experts must then devote a massive amount of time to (a) efforts to obtain information necessary to conduct the required analysis, much of which is in the sole possession of the railroad and must be sought through the Commission's discovery procedures, (b) conduct and present the requisite analysis, (c) respond to railroad attacks on the analysis, and (d) dissect the counter stand-alone analysis which will ordinarily be presented by the railroad, in order to demonstrate its deficiencies. In short, the stand-alone cost constraint is, at best, a witheringly complex undertaking, entailing a massive amount of effort and tremendous expense. For this reason alone, it is totally out of the question as a meaningful "remedy" for most captive rail shippers. Even for those few shippers who may be able to afford to pursue a stand-alone cost case, under this type of analysis only shippers who are moving very large volumes of traffic for long periods of time over high density rail lines where a large percentage of the traffic is coal or other bulk commodities will haver any faint hope of obtaining relief.

Not only is the stand alone cost concept unworkable in practice, it is also inappropriate as a measure of rate reasonableness. Since stand alone cost represents the level at which shippers could provide the service themselves, it produces a price level that even a monopolist could not charge without losing the traffic. The stand alone price is, in effect, the maximum price which could be charged by a profit-maximizing monopolist. It is indefensible for the Commission to adopt, as a "reasonable" rate the monopoly price.

(b) The Revenue Adequacy Constraint

As spelled out in the Commission's Guidelines, the revenue adequacy constraint dictates that "captive shippers should not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs." (*Id.* at 18.) Apparently, the only way this constraint could be used to show an individual rate to be too high would be for a shipper to establish (a) that the railroad involved is revenue adequate, and (b) that the degree of differential pricing reflected in the challenged rate is not necessary for the railroad to remain revenue adequate.

As to the first element of this showing, the Guidelines make it clear that existing revenue adequacy standards will apply. Further, they stress that revenue adequacy is a long-term concept, and that the fact that a railroad may have adequate revenues for one or more years does not establish that it has "achieved" revenue adequacy. The Commission specifically declined to decide that period of time it may be appropriate to focus upon in determining revenue adequacy, leaving that for case-by-case determination. As to the second element of the showing required to invoke the revenue adequacy constraint, the Commission gives no indication of how it might be satisfied.

The Commission's failure to make any attempt to explain how a shipper might resort to this constraint is entirely understandable given the fact that under the current revenue adequacy standards, it is unlikely that any railroad will be found to have adequate revenues at any point in the reasonably foreseeable future. Despite the widely-acknowledged and well-documented disparity between the assessments of the railroads' financial health under the Commission's revenue adequacy standards and in the real world, the Commission, in the Coal Rate Guidelines decision, reaffirms its standards as representing "a reasonable level of profitability for a healthy carrier." Until realistic standards of revenue adequacy are employed, the revenue adequacy constraint is utterly useless.

(c) The Management Efficiency Constraint

The stated purpose of the management efficiency constraint is to protect captive coal shippers from bearing the costs of demonstrated railroad inefficiencies. The first step in conducting this analysis is to define the extent of a railroad's revenue need shortfall, namely the difference between its actual revenues and the level of revenues deemed to be adquate under the Commission's revenue adequacy standards. This revenue shortfall can then be reduced by the amounts of revenue losses or avoidable costs which the shipper can demonstrate are attributable to the railroad's inefficiency.

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[34] Ex Parte No. 347 (Sub-No. 1), supra, at 33.

The Commission identifies three types of railroad inefficiencies which may be analyzed: operating inefficiencies, plant inefficiencies, and pricing inefficiencies. The decision does not elaborate on operating inefficiencies, but presumably an example might be a demonstration that a railroad makes a standard practice of using five locomotives to move a train where three would suffice. Presumably the cost associated with the use of the two unneeded locomotives would be disallowed in determining the railroad's revenue adequacy.

Because the rate of return required for revenue adequacy under the ICC standards assumes that all assets in the railroad's investment base are fully productive, the Commission says that if a shipper can establish that specific rail assets do not need to be maintained or replaced, the railroad's revenue shortfall will be reduced to eliminate some portion of the return on such assets. The Commisison establishes long-run marginal costs as the standard for determining whether assets are capable of earning a return sufficient to warrant their replacement.[35]

The analysis concerning pricing inefficiencies is performed on both a short-run and a long-run basis. In the short-run analysis, the shipper may attempt to demonstrate that the railroad is losing money by hauling traffic at rates which are less than the short-run marginal costs for the traffic. The long-run analysis is the same as that required in examining plant inefficiencies, i.e., long-run marginal costs. In order to develop the evidence necessary to make the necessary evidentiary showings concerning either plant or pricing inefficiencies, the shipper must conduct a cost analysis of the railroad's entire traffic base in order to identify traffic which may be moving at rates below either short-run or long-run marginal costs.

Any revenue losses or avoidable costs which the shipper can establish are attributable to railroad inefficiency will be deducted from the railroad's revenue shortfall. Once the "corrected shortfall" has been established in this fashion, the shipper will be required to demonstrate that the level of differential pricing contained in the rate under challenge is more than the amount of the railroad's revenue needs which properly can be allocated to its traffic under Ramsey Pricing principles.[36] To make this showing, the shipper must analyze the demand characteristics of all the railroad's traffic in order to determine its appropriate "share" of the railroad's revenue needs.

The complexity, difficulty, and expense of the stand-alone cost analysis are dwarfed in comparison to the effort a shipper must undertake in order to pursue the management efficiency analysis. In order to determine whether a railroad's revenue shortfall is attributable, in part, to operating inefficiences, the shipper must (a) analyze the railroad's operations to examine their efficiency; (b) conduct a cost analysis of all the railroad's traffic in order to determine what traffic might be moving at rates which are (i) less than short-run marginal costs, or (ii) less than long-run marginal costs; and (c) scrutinize the assets in the railroad's investment base in an effort to identify those assets which long-run marginal cost analysis indicates have lost all or part of their capacity to earn a fair return. Each of these steps individually is a massive undertaking. Each requires analysis of tremendous amounts of information, most of which is in the exclusive possession of the railroad, and therefore must be sought through the discovery process. In the past, the Commission has refused to compel the railroads to provide much of the information required. In the Coal Rate Guidelines decision it purports to recognize that extensive discovery will be required to litigate a case under its new guidelines, but at the same time it appears to impose requirements of specificity with regard to data and information sought to be discovered which may prove impossible to satisfy.

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[35] "Our LRMC test simply recognizes that a carrier may have excess facilities that will probably not be replaced. Hence, the carrier has no need for funds to replace them." Ex Parte No. 347 (Sub-No. 1), supra, at 22, note 45.

[36] Ramsey Pricing is a method of differential pricing long advocated by the railroads. Under Ramsey Pricing, each rate contains a mark-up over long run marginal costs in order to cover a portion of what are determined to be "attributable" costs (in this case, the railroad's revenue shortfall). The unattributable costs are allocated among all rail customers in inverse relation to their demand elasticity. Under Ramsey Pricing, the more captive a shipper is and the less able he is to vary his demand for rail service, the greater the contribution to revenue adequacy he is required to make. In essence, Ramsey Pricing is "what the market will bear" pricing.

Once a shipper has completed the managment efficiency analysis, as daunting as that undertaking is, it faces an even more difficult task, namely conducting a Ramsey Pricing analysis of the railroad's entire traffic base in an effort to demonstrate that its rate exceeds the "Ramsey optimal rate" (Ex Parte No. 347 (Sub-No. 1) at 26). In order to conduct this analysis, the shipper must present evidence concerning the demand elasticities of all of the railroad's traffic. The Commission has consistently rejected, in the past, the railroads' efforts to impose such a requirement on shippers, because it has recognized the total impracticability of such a requirement.

The cumulative effect of the burdens associated with an effort to develop a case under the management efficiency constraints is to render it entirely illusory as a remedy. The Commission has constructed an elaborate theoretical system which cannot practically be implemented. Since the shipper bears the burden of proof, the unworkability of the system translates into a guaranteed loss for the shipper and victory for the railroad.

(d) The Phase-In Constraint

The final constraint under the Commission's Guidelines is that the Commission may require that a rate increase found to be lawful under the stand-alone cost, revenue adequacy, and management inefficiency analyses only be allowed to take effect in stages over some prescribed period of time in order to avoid "severe economic dislocations." The necessity for a phase-in and the type of phase-in which might be required is a matter left for case-by-case determination.

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Viewed in their most favorable light, the Commission's Coal Rate Guidelines fail to provide any meaningful measure of protection for the vast majority of captive rail shippers. In this regard, it should be recognized that all indications are that this same ratemaking methodology soon will be applied to commodities other than coal.

3. The Market Dominance Proceedings (Ex Parte No. 320 (Sub-Nos. 2 and 3)

"Market dominance" is a concept central to the ICC's jurisdiction over rate reasonableness. Under the Interstate Commerce Act, the ICC has jurisdiction to determine whether a rail rate is unreasonably high only in those instances where the involved railroad possesses "market dominance" over the transportation to which the rate applies.

The market dominance standard was added to the Interstate Commerce Act by the 4-R Act. In October of 1976, the ICC promulgated rules for determining railroad market dominance.[37] These rules defined the relevant market for market dominance purposes as the market for transportation services between the origin and destination of the involved traffic, and established three fact patterns that gave rise to a rebuttable presumption of railraod market dominance: (i) where the proponent railroad handled 70% of or more of the involved traffic during the preceeding years; (ii) where the rate in issue exceeded the variable cost of providing the service by 60% or more; or (iii) where the affected shipper had made a substantial investment in rail related equipment and facilities.

In the Staggers Act, Congress amended the 4-R Act market dominance provisions by adding a jurisdictional threshold.[38] Under the Staggers Act jurisdictional threshold test, the ICC can now make a finding of market dominance only if the involved railroad rate is set at a revenue/variable-cost ratio greater than a stated percentage, currently 180% of variable cost.[39]

Two months after the enactment of the Staggers Act, the ICC proposed two major changes in its treatment of market dominance.[40] Specifically, the ICC proposed to scrap its market dominance presumptions; to expand its definition of the relevant market for market dominance purposes (thus allowing the parties to attempt to define the relevant product and geographic markets based upon the facts of individual cases); and to substitute evidentiary "guidelines" to assist the parties in presenting market dominance evidence.

Over the universal complaint of shipper parties, the ICC adopted its market dominance proposals in 1981 and once they went into effect, market dominance proceedings became tortuous exercises involving complex evidence of market definition, market share, etc.[41] Moreover, different decision-makers in the same case (*e.g* Revew Boards, Divisions of the Commission, the full Commission) frequently reversed each other on market dominance conclusions.[42]

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[37] Ex Parte No. 320, Special Procedures for Making Findings of Market Dominance as Required by the Railroad Revitalization and Regulatory Reform Act of 1976, 355 I.C.C. 12 (1976).

[38] Staggers Act § 202, 94 Stat 1900-01.

[39] *See* 49 U.S.C. § 10709(d).

[40] Ex Parte No. 320 (Sub-No. 2), Market Dominance Determinations and Consideration of Product Competition, 45 Fed. Reg. 83342 (1980).

Because of the problems which the Commission's Ex Parte No. 320 (Sub-No. 2) decision was generating, the subject of market dominance was placed on the docket for discussion in the Commission's Ex Parte No. 456 proceeding. In this proceeding, the Association of American Railroads ("AAR") and the National Industrial Transportation League ("NITL") adopted a compromise proposal which places the burden on railroads in ICC rate cases to prove that geographic or product competition present effective competition, and also provided that evidence of market dominance at an origin point would not be dispositive of market dominance at a destination point and vice versa. This agreement was subsequently considered by the ICC in its Ex Parte No. 320 (Sub-No. 3) proceeding. In July of 1985, the ICC held an open conference where the Commissioners voted to approve, and to promulgate, the AAR/NITL compromise. A written decision was issued by the Commission on October 31, 1985 which, upon a preliminary review, appears to do little beyond adoption of the AAR/NITL compromise in the fashion approved at the July open conference.[43]

While the changes set forth in the AAR/NITL compromise have some benefits for captive shippers, even with such changes the shippers must continue to unnecessarily engage in complex evidentiary presentations in an effort to convince the ICC of the necessity to assert its jurisdiction.

4. The ICC Inflation Index Proceeding (Ex Parte No. 290 (Sub-No. 2))

An issue of critical concern to both railroads and shippers in the Staggers Act involved the establishment of procedures that would permit the railroads to automatically recoup, through their freight rates, cost increases they incurred due to inflation. Prior to the Staggers Act, the railroad industry would periodically come before the Commission in so-called "general rate increase proceedings" and request across-the-board increases in rail freight rates in order to recoup, inter alia, cost increases due to inflation. Given the inflationary spiral which hit the United States in the late 1970's, general increase proceedings became more and more frequent and the costs of processing these cases dramatically increased. Under this system, the railroads were continuously exposed to a regulatory lag between increases in their costs due to inflation and approval of general rate increases to cover such costs.

In the Staggers Act, Congress came up with a sound method for dealing with the cost inflation/rate pass-through problem. Pursuant to Section 203 of the Staggers Act, the ICC was called upon to devise an index which measured railroad cost increases due to inflation.[44] The railroads are permitted, on a quarterly basis, to increase their freight rates by the percentage change in this ICC index. Because the purpose of these rate increases in merely to offset increases in costs, they are completely shielded from challenge by shippers.

While the cost recovery rate increase concept is sound, the ICC has adopted an inflation index which overstates the railroads' cost increases. The principal problem with the index—which was promulgated by the ICC in its Ex Parte No. 290 (Sub-No. 2) proceeding [45]– is that it measures only changes in the prices railroads pay for goods and services (input prices), and does not take into account the acknowledged effect of productivity changes on the railroads' cost of producing services (output).[46] For example, if prices paid by the rail industry for fuel increased 20%, the ICC's cost recovery index would rise accordingly, even if the industry was moving twice as much freight per gallon of fuel so that actual output costs per unit of output had not risen but fallen.

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[41] The text of the 4-R Act makes clear that Congress intended that market dominance regulations "shall be designed to provide for a practical determination [of market dominance] without administrative delay." 4-R Act 202(a). Similarly, the Senate Commerce Committee observed:

> Lengthy antitrust-type litigation will be avoided by virtue of the Commission's authority to adopt rules of practical application which will identify markets in which dominance exists.

S. Rep No. 94-499, 94th Cong., 1st Sess. 47 (1975).

[42] EEI presented a comprehensive review of these problems in its November 5, 1984 filing in Ex Parte No. 456, The Staggers Rail Act of 1980—Conference of Interested Parties.

[43] Ex Parte No. 320 (Sub-No. 3), Product and Geographic Competition, Decision served October 31, 1985.

[44] 94 Stat. 1901-02.

[45] Ex Parte No. 290 (Sub-No. 2), Railroad Cost Recovery Procedures, 364 I.C.C. 841 (1981).

[46] "Productivity" as used in this discussion simply means the efficiency with which inputs (labor, material, etc.) are used to produce outputs. A productivity increase—i.e., an increase in the amount of output produced by the same inputs, or a reduction in the inputs required to produce the same output, or a combination of the two—can result from a number of different sources, including technological changes, changes in input or output mix, and volume increases.

While the United States Court of Appeals for the D.C. Circuit affirmed the ICC's decision in Ex Parte No. 290 (Sub-No. 2), it noted that the Commission should adopt a productivity adjustment if a valid adjustment could be formulated.[47] On request of rail shippers, on July 26, 1982 (47 Fed. Reg. 32176) the ICC instituted an investigation entitled Ex Parte No. 290 (Sub-No. 4), Railroad Cost Recovery Procedures-Productivity Adjustment. In comments filed on October 25, 1982, shippers provided specific standards for measuring rail productivity and for adjusting the ICC inflation index to properly account for rail productivity changes. Almost two years later, following an August 30, 1984 order from the Court of Appeals for the D.C. Circuit requiring from the ICC a status report on this matter, the ICC issued a "Notice of Proposed Rulemaking" on September 27, 1984. In that notice, the ICC asked for "additional comments," including "comments on whether a productivity adjustment should be made at all." Although EEI and other rail shippers again filed extensive comments, at this point another year has passed and the ICC has taken no further action. Thus, the ICC is still questioning whether a productivity adjustment should be made at all. While the ICC waits, and does nothing, shippers continue to be overcharged because of the Commission's failure to accurately reflect increases in railroad costs.

Another distinct problem with the ICC's methodology is that it only allows rates to increase. When rail costs go up—so do the rates. But when rail costs go down, no corresponding downward rate adjustments are required. Since the rail industry is entitled under the law to rate increases to offset rising costs on an "automatic" basis, it is sound and fair policy for there to be corresponding decreases in rates when railroad costs go down.

* * * * * * *

As the foregoing discussion reveals, the ICC's major rulemaking decisions have ignored the legitimate interests and concerns of captive coal shippers. Their combined effect has been to permit the railroads to establish and maintain grossly excessive rates on captive coal traffic.

ICC POLICIES HAVE ALLOWED THE RAILROADS TO CHARGE EXCESSIVE RATES

One of the statistics repeatedly referred to by the railroads and the ICC traces the average rail rate increases on coal since enactment of the Staggers Act in comparison to the performance of various inflation indices for the same period. The rough similarity in these figures is then asserted as "proof" that ICC implementation of the Staggers Act has not permitted rail market power abuse of captive coal shippers in the area of rates. The argument is misleading for at least two reasons.

First, using a general average of all rate increases fails to reflect major increases on individual movements. Second, the railroads and their supporters ignore the fact that for a significant number of coal burning utilities, the most significant harm flowing from ICC policies under the Staggers Act is found in the protection and perpetuation of *pre*-Staggers Act rate actions, rather than the encouragement of post-1980 abuses. The railroads and the ICC claim to have looked for abuse and found none. In truth, they have been deliberately looking in the wrong place. A more meaningful period of time for viewing the extent to which rail rates have increased is the period since passage of the 4-R Act in 1976. During the period 1976–1980, rail rates on coal increased approximately 62 percent, far more than the rate of inflation, which was approximately 27 percent.[48]

To a large extent, however, the question of how fast and how much rail rates for coal have increased is beside the point. The important question is whether the ICC has formulated policies which are allowing the railroads to charge excessive rates on captive coal traffic. We believe available evidence of the profitability of rail coal rates confirms that it has.

It is important to note that the vast majority of coal transported by rail moves in highly efficient unit train or trainload shipments. Also, utility shippers are providing more equipment, thereby reducing the railroad's costs. Utilities currently own more than 33,000 coal cars, a ten-fold increase in the last ten years, and have made substantial investments in terminal facilities. All of this must be considered in tandem with recent, substantial productivity increases in the railroad industry itself.

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[47] *Western Coal Traffic League* v. *United States*, 677 F.2d 915 (D.C. Cir.), cert. denied, 459 U.S. 1086 (1982).

[48] See "Review of Association of American Railroads Paper 'Coal Rate Facts'," Edison Electric Institute, June, 1984, at 9.

The Edison Electric Institute recently conducted an analysis of the profitability inherent in the tariffs of 19 specific captive utilities. The analysis was made when a recent DOE study of railroad rates failed to determine the profitability of the rates in the eight case studies selected by the DOE. Our analysis used standard ICC methodology for determining and allocating costs and data provided to the ICC by these companies in their rate complaints. The analysis accounted for unit train efficiencies experienced in those haulages. The analysis showed that the pre-tax returns on investment by the railroads inherent in these coal tariffs ranged from a low of 51% to a high of 157%. (See Tables included as Attachment 1.)

A few of the utilities involved in the DOE study and our analysis have since experienced the benefits of competition and have negotiated contracts at reduced rates. Most, however, along with the majority of other coal shippers, remain captive and continue to pay the rates which generate bloated returns. The substantial rate reductions that have occurred in those few instances where competition has intruded into a formerly captive rail haulage situation also provide strong evidence that some captive coal shipper rates are excessive.

The City of San Antonio's problems with its Burlington Northern rail haulage rates are well known. From 1976 to 1985, the San Antonio public utility, which was captive to the Burlington Northern for its Powder River Basin, Wyoming coal, experienced a coal haulage rate increase from $10.93 to $27.66 per ton. In early 1985, after the Chicago and Northwestern Railroad was allowed to enter the lower part of the Powder River Basin to compete with the Burlington Northern, San Antonio received public bids from both railroads. When the bids were opened, the C&NW had won with an effective rate of approximately $19.60 per ton, a reduction of $8.06 per ton or 29%. In addition, Burlington Northern had offered to reduce its own rate $4.66 per ton, or 17%, in an effort to keep the business. The winning rate reduction per ton was greater than the amount of money San Antonio was paying for its coal at the mine mouth.

Certain other utilities in the Southwest have benefitted from this same infusion of competition and have received significant rate decreases, ranging from an estimated 18 to 29 percent. A summary of some of these cases is shown below:

THE EFFECT OF COMPETITION ON RAIL RATES

Shipper	Old captive rate	New competitive rate	Reduction	Per cent reduction
San Antonio (City Public Service)	[1] $27.66	[3] $19.60	$8.06	29
		[4] 23.00	4.66	17
Lower Colorado River Authority	[1] 26.67	[1] 22.00	4.67	18
Arkansas Power and Light	[1] [2] 23.00	[2] [3] 18.50	4.50	20
Houston Lighting and Power	[1] 25.73	[2] [3] 19.00	6.73	26
Southwestern Public Service	[1] 17.50	[2] [3] 12.50	5.00	29

[1] Burlington Northern.
[2] Estimated
[3] Chicago and Northwestern
[4] Burlington Northern bid.

A number of the tariff rates that were being charged to the utilities listed above prior to the introduction of competition had been litigated before the Commission, and in each case the railroads took the position that they yielded earnings far below levels necessary to generate a sufficient return on investment to attract capital and produce a fair profit. Yet, when faced with the realities of the marketplace, significant reductions suddenly became possible. Notwithstanding that the ICC never ordered a reduction in any of these challenged tariff rates, the railroads themselves found ample room to offer major reductions.

Unfortunately, competition is not likely to develop for the majority of captive shippers. To the contrary, the trend among major railroads is not toward new market entry, but consolidation and concentrations of market power:

Burlington Northern acquired the St. Louis-San Francisco Railway in 1980.

The Chessie System Railroads and the Seaboard Coast Line Railroad were consolidated in 1980 under the umbrella of the CSX Corporation.

Union Pacific acquired the Missouri Pacific and Western Pacific in 1982.

In 1982, the Norfolk & Western Railroad and the Southern Railway were consolidated under the common control of Norfolk Southern Corporation.

In a case that is still pending before the ICC, the Santa Fe and the Southern Pacific are seeking authority to conduct operations under one corporate umbrella.

In a dramatic extension of intermodal market power, CSX Corporation acquired American Commercial Barge Lines in 1984.

If the pending sale of Conrail to the Norfolk Southern system (parent of the "revenue inadequate" Norfolk & Western and Southern Railway) is approved, three major railroad systems will handle over 80% of all coal traffic in the United States, and over two-thirds of the coal delivered to captive power plants.

The handwriting is on the wall: meaningful enforcement of the captive shipper protections built by Congress into the Interstate Commerce Act in 1980 is crucial if the ever-increasing concentrations of rail market power are to be prevented from exacerbating the exploitation of captive coal traffic.

LEGISLATIVE RELIEF IS NECESSARY

The electric utility industry supports the fundamental goals of the Staggers Rail Act, and believes that in a great many areas the Staggers Act has worked well and has been implemented by the ICC in such a manner as to carry out the intent of Congress. We wish to make it clear to this Subcommittee that we stand firmly opposed to any effort to "turn back the clock" or otherwise drastically change the reform legislation enacted in 1980.

Despite the many successes, however, there remains one glaring failure under the Act: the ICC's indifference to the plight of captive shippers of bulk commodities, and its accompanying failure to give effect to those provisions of the Act designed by Congress to protect such shippers. Coal users and the consumers they serve have been the principal victims of the Commission's biased interpretations and applications of the law. The ICC's revenue adequacy test and the rate reasonableness considerations employed since the Staggers Act have combined to ensure that not one captive coal shipper has been successful in challenging a rail rate.[49]

In 1983, concurrent with the Staggers Act oversight hearings held by this Subcommittee that summer, a call went up from captive shippers for legislative action to correct the inequitable treatment captive shippers were receiving under the ICC's one-dimensional policies. The response of many—including many members of this Subcommittee—was to give the ICC a chance to hear the message and recognize and rectify its problems on its own. Ostensibly to this end, the ICC conducted its own oversight proceeding last year, known as Ex Parte No. 456. However, neither that proceeding nor either of its ensuing proceedings have alleviated the need for legislation.

First, and most importantly, the ICC proceeding produced absolutely nothing with respect to the problems of captive shippers under the Commission's revenue adequacy and maximum rate reasonableness standards. Only two problem areas were addressed in the final analysis: the question of market dominance and the matter of so-called "competitive access" issues, including joint rates and reciprocal switching.

The new market dominance guidelines (Ex Parte No. 320 (Sub-No. 3) make helpful changes in allocations of the burden of persuasion as between a shipper and railroad, but fail to meaningfully improve upon the complex, antitrust-type showing required.

The effect of Ex Parte No. 445 (Sub-No.1),[50] the so-called "competitive access" rules, is very unclear, since the ICC's recent decision in *Midtec Paper Corporation* v. *Chicago & North Western Transportation Company*[51] appears to have eliminated much of what those rules appeared to address.

The evidence makes it clear that neither Congress nor captive shippers can afford to "wait and see" any longer. While a comprehensive overhaul of the Staggers Act is neither required nor desirable, there remains no alternative but legislative action to ensure a future enforcement of captive shipper protections, and to achieve the balanced approach to railroad rate regulation which Congress so clearly mandated in 1980.

To accomplish this goal, we strongly urge action by the Congress to rectify the misguided manner in which the Interstate Commerce Commission has implemented the Staggers Rail Act captive shipper protections. We support legislation that is pending before the Transportation Subcommittee, the Consumer Rail Equity Act (S. 477).

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[49] See footnote 1, *supra*.

[50] Ex Parte No. 445 (Sub-No. 1), Intramodal Rail Competition, Decision served October 31, 1985.

[51] ICC Docket No., 39621, Decision served July 17, 1985.

The Interstate Commerce Commission must be made to:

Adopt a responsible and sensible test for railroad revenue adequacy that uses generally accepted utility regulatory commission practices to produce an accurate picture of a railroad's financial health;

Fairly allocate burdens of proof between captive shippers and the railroad on certain key issues of jurisdiction and the merits of substantive rate relief;

Adopt and implement a fair, workable and realistic rate reasonableness standard for captive shipper rates; and

Utilize a mechanism for quarterly cost recovery rate adjustments that fully considers the impact of changes in railroad productivity and requires automatic rail rate decreases (on all movements subject to automatic increases when costs rise) when the ICC's index of rail costs declines.

We appreciate the opportunity to present the position of the Edison Electric Institute on this important consumer issue before the Subcommittee.

Attachment 1

UTILITIES INCLUDED IN DRAFT DOE STUDY

Pre-Tax Return on Investment (ROI)

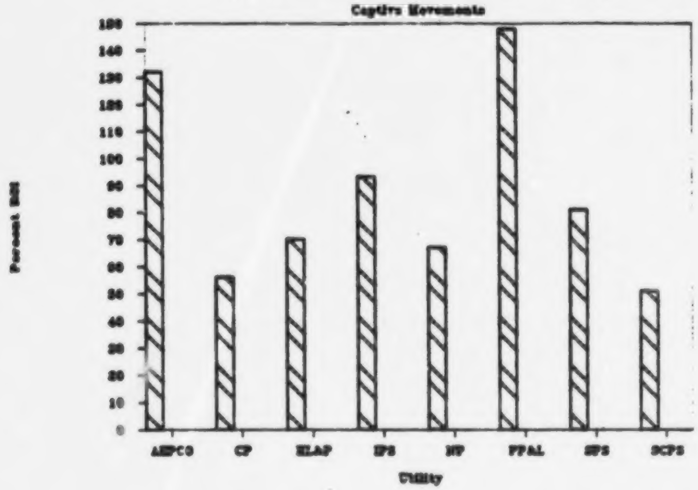

TABLE 1

Estimated Pre-Tax Return on Railroad Investment Used to Provide Service to Utilities with Captive Coal Movements (1984): 8 Utilities Included in the Draft Department of Energy Study

Utility	Railroad	Pre-tax Return on Investment Used in Captive Utility Coal Movement
Arizona Elec. Power Co-Op	Santa Fe	132%
Consumers Power	C&O	56%
Houston Lighting & Power	BN	70%
Iowa Public Service	BN	93%
Nevada Power	UP	67%
Pennsylvania Power & Light	Conrail	148%
Southwestern Public Service	BN	81%
South Carolina Public Service Authority	Seaboard	51%

ADDITIONAL UTILITIES STUDIED BY EEI

Pre-Tax Return on Investment (ROI)

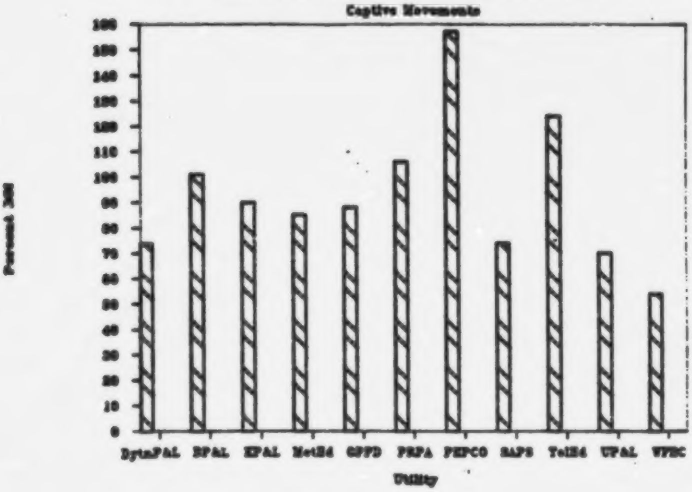

TABLE 2

Estimated Pre-Tax Return on Railroad Investment Used to Provide Service to Utilities With Captive Coal Movements (1984): 11 Additional Utilities

Utility	Railroad	Pre-Tax Return On Investment Used in Captive Utility Coal Movement
Dayton Power & Light	Seaboard	74%
Delmarva Power & Light	Conrail	101%
Kansas Power & Light	UP	90%
Metropolitan Edison	Conrail	85%
Omaha Public Power Authority	BN	88%
Platte River Power Authority	BN	106%
Potomac Electric Power Company	B&O	157%
San Antonio (City of)	BN	74%
Toledo Edison	N&W	124%
Utah Power & Light	Denver Rio Grande	70%
Western Farmers Elec. Co-Op	BN	54%

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STATEMENT OF THE NATIONAL CONSUMERS LEAGUE

The National Consumers League has concluded that the Interstate Commerce Commission has failed to use its authority to protect "captive shippers" who are subject to railroad monopoly power from excessive rates. Unfortunately, higher prices at the marketplace are the result. Affected by this monopoly situation are prices for electricity, coal, agricultural products and manfactured commodities in both domestic and world markets.

The National Consumers League therefore wishes to go on record in support of the Consumer Rail Equity Act, S. 477 and R.R. 1190.

The two bills in question will accomplish the desired purpose of establishing a more reasonable means for testing revenue adequacy than now used by the ICC. The legisiation would direct the ICC to consider different criteria, based on more realistic financial indicators, for assessing revenue adequacy.

The NCL feels that it is not consistent with an enlightened energy policy to allow an overly generous rate of return for transport of products vital in the production of energy. Also in terms of its concern with national policy, the NCL endorses the Consumer Rail Equity Act because its enactment should reduce the prices for transporting the many commodities which are subject to the severe competitive pressures of the world market.

In the very simplest terms, the NCL expects that the Consumer Rail Equity Act will correct a monopoly pricing situation and allow the American consumer to benefit from better pricing practices.

The National Consumers League is not suggesting that the railroad industry should be reregulated.

Founded in 1899, the National Consumers League is a private nonprofit membership organization. Its principal goal is to represent consumer and worker interests before government and business decisionmakers. The National Consumers League advocates for consumer access to quality affordable health care, food and drug safety, and fair tax and economic policies for consumers.

STATEMENT OF THE SOCIETY OF THE PLASTICS INDUSTRY, INC., COMMITTEE ON TRANSPORTATION AND DISTRIBUTION

INTRODUCTION

In enacting the Staggers Act in 1980, Congress recognized the need for intra-rail competition, the need for the marketplace to act as the regulator, and the need for the railroad industry to become revenue adequate. The law is direct and specific: "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail."

The Plastics Industry's distributions systems are primarily designed for rail transportation. On average, over 85 percent of plastic resins move from the producing plants by rail; hence, the industry is dependent upon an efficient, competitively priced nation-wide rail system. The Plastics Industry, through The Society of the Plastics Industry, Inc. (SPI) Committee on Transportation and Distribution, supports the goals and principles of the Staggers Act of 1980 and the attempts to reduce excessive regulation of the railroad industry. However, the Staggers Act has in many ways been interpreted much more broadly than the original guidelines indicated. The railroads have distorted the goals of the Staggers Act and have made a determined effort to reduce competition under the guise of eliminating inefficient routes. Competition, joint rates, market dominance, and revenue adequacy have all taken on new definitions developed from the railroads' new dictionary and embraced by the ICC.

SPI is not changing its position of support of the Staggers Act, but is in favor of an in-depth review of many of the changes made in rail transportation service through interpretations of the Act.

1. Anticompetitive Practices

A. Elimination of Joint Routes and Rates and Cancellation of Gateways

Since enactment of the Staggers Act, railroads have engaged in the practice of eliminating joint routes and rates specifically to reduce competition or establish a monopoly position, and they have cancelled gateways as a step toward maximizing individual rail movements. The closing of gateways automatically reduces or eliminates available alternate routes. The elimination of joint routes and rates, and the cancellation of long established gateways have resulted in a plethora of shipper complaints regarding rate increases and reduced services. The very existence of the nation's shortline railroads has been threatened by these predatory practices.

SPI believes that regulatory permission to cancel joint routes and rates must be based on the inefficiency of operations in regard to a particular carrier standing alone and without consideration of route alternatives. Gateway cancellations should not be permitted as a means to reduce competition and maximize revenues. Route and gateway concellations, not so justified, should be restored.

The captive shipper dependent on single line services must be accorded an intramodal alternative. Just and reasonable rates without a competitive rail industry are a myth. It is SPI's position that monopoly powers inherent in captive single line movement could be ameliorated by mandating publication of joint line routes at the request of a competing railroad, or by requiring the publication of proportional rates when shippers are denied a free market option to obtain reasonable rates.

B. Trackage Rights

Trackage rights provide a means of assuring rail competition where a shipper or group of shippers are captive to a single carrier. Mutually developed trackage rights agreements generally reflect operating or service efficiencies (e.g., balance available power in a given area), established through exchange of trackage rights in different areas of the participating railroads. Mandated trackage rights may prevent the loss of competition through mergers (e.g., SP-Santa Fe, Union Pacific-Missouri Pacific, and Norfolk and Western-Southern), or may increase competition when noncompetitive pricing has adversely impacted captive shippers' ability to compete in the marketplace.

Accordingly, SPI supports and encourages appropriate carrier negotiated trackage rights, including those which would preserve intra-rail competition that would otherwise be lost due to mergers, restricted service, or abandonments. In the absence of properly negotiated trackage rights, the granting of trackage rights should be mandated by the ICC when necessary to preserve adequate competition and when a competitive carrier has requested the rights. Similarly, where trackage rights provide an appropriate corrective action, they should be mandated to alleviate anticompetitive pricing for captive shippers. Under any mandated circumstances the carrier granting the trackage rights should be reasonably compensated for any added costs incurred to provide the tackage rights (interchange service, yard operations, etc.).

C. Reciprocal Switching

One of the traditional means of assuring intrarail competition is the reciprocal switching arrangement, whereby individual cars, groups of cars, and trains are transferred between railroads serving a common terminal point. The railroads entered the agreements voluntarily and usually provided the service at no charge, or for a nominal amount. The Staggers Act provides the ICC with the authority to compel carriers to provide reciprocal switching. Since the enactment of the statute, however, the railroads have been engaged in an industry-wide campaign to eliminate reciprocal switching arrangements, or to price them so exorbitantly that the effect is the same. The ICC's continued failure to implement the statutory provision for reciprocal switching has encouraged the carriers to expand their anticompetitive activity.

SPI believes that appropriate action must be taken to ensure the maintenance and/or promotion of competition between railroads by mandating the ICC to implement the Act's provision concerning reciprocal switching arrangements.

2. Challenging Excessive Rates

In view of the growing anticompetitive climate, nurtured by the elimination of joint routes and rates and the failure to enforce tracking rights and reciprocal switching agreements, it is imperative that shippers have an effective means to challenge unreasonable rates of market dominant carriers. However, due to the ICC's erroneous analyses of market dominance and revenue adequacy, the Staggers Act's provisions for challenging rates have been unavailing.

A. Market Dominance

The Interstate Commerce Commission (ICC) has misinterpreted the concept of market dominance and, as a result, has improperly restricted its jurisdiction over rail rate reasonableness. The concept of market dominance, introduced into the Interstate Commerce Act by the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act), requires that a shipper must demonstrate the lack of effective competition from other carriers or others modes of transportation in order to challenge a rail rate as being unreasonably high. Following enactment of the Staggers Act, the ICC reopened its rules, which were adopted based on the 4-R Act market dominance test, and reinterpreted the meaning of market dominance. The new interpretation not only takes into account competition for the transportation to which the rate applies, *i.e.*, head-to-head competition between rail carriers, but also requires consideration of product and geographic competition. These additional considerations involve analysis of the substitutability of different products or of similar products from other sources. The underlying economic theory is that the railroad will maintain reasonable rates if product or geographic competition threaten the movement altogether.

Economic theories that product and geographic competitions serve as constraints on pricing are valid with respect to product pricing generally. Thus, it is not uncommon to find allowances from the selling price of products and materials that equalize the selling price with the delivered price available to the purchaser from alternative suppliers. The economic theory and practice of such pricing constraints do not, however, automatically apply to product constituent costs. The rail carrier does not feel a constraint on the pricing of its service until the transportation cost, aggregated with all other costs to the shipper, reaches the level of pricing the shipper out of the marketplace. Until that point, a shipper may simply be required to absorb the rail rate in order to maintain a place in the market, and may only be able to cover marginal costs and make some nominal contribution towards overhead fixed costs.

It is SPI's position that market dominance should not be determined according to theories of product or geographic markets. Rather, market dominance should, as originally interpreted by the ICC, refer to those situations where there is a lack of effective competition for the rail transportation service between the point of origin and the point of destination for movement of the product involved.

B. Revenue Adequacy

Although the Staggers Act contemplates that the objective of revenue adequacy for railroads be balanced against protection of shippers, the ICC's miscalculations of revenue adequacy have resulted in countless undue findings of rail rate reasonableness. The ICC found that three railroads earned adequate revenues in 1979, two were revenue adequate in 1981, and none earned adequate revenues in 1982. These findings could well be interpreted as implying that the Staggers Act has failed to improve the lot of the railroad industry through reduction of regulation by the ICC. Such an interpretation is in sharp contrast to the public pronouncements of spokespersons from the ICC itself, the American Association of Railroads (AAR), the U.S. Department of Transportation, and individual railroads. The U.S. General Accounting Office (GAO) reported to Congress on August 17, 1983, that the ICC's findings do not agree with evaluations made by others.

SPI also believes that the railroad industry is much healthier than the ICC's revenue adequacy proceedings indicate. SPI further believes that the paradox is due to the ICC's improper use of only one measure—return on investments—and its incorrect calculation of cost of capital as the yardstick against which return on investment is measured.

No one financial criterion can be used to the exclusion of all others in determining revenue adequacy. Different ratios and yardsticks each measure discrete aspects of a firm's strength or performance. The railroads and government agencies other than the ICC have recognized this. Congress also recognized this and provided that numerous criteria should be considered. Under Section 205 of the Staggers Act, the determination is to be based on the adequacy of revenue to: cover total operating expenses including depreciation and obsolescence, and profit and/or return on capital; provide a flow of net income plus depreciation adequate to support prudent capital outlays, assure repayment of the reasonable level of debt, permit raising needed equity capital, and cover the effects of inflation; and attract and retain enough capital to provide a sound transportation system in the United States.

SPI favors the approach used in the Rahall Bill (H.R. Rep. 2584, 98th Congress) for evaluating revenue adequacy. That Bill would have required the ICC to consider a number of financial indicators including, but not limited to, the following: bond ratings, return on investment, return on shareholders' equity, return on total capitalization, fix-charge coverage, debt-to-equity ratio and operating ratio. These financial indicators reflect the criteria considered by the financial community in making its investment decisions. If the financial community takes into account a number of different measures in making such decisions, so must the ICC if it is to accurately determine whether railroad revenues are adequate.

CONCLUSION

In sum, to preserve competition in the rail industry, SPI requests that the practices of eliminating joint routes and rates and cancelling gateways should be prohibited except where based upon service inefficiencies. Assurance of intrarail competition and protection against excessive and unreasonable pricing can also be accomplished through enforcing tracking rights and reciprocal switching agreements. In the absence of effective alternative rail transportation services, the ICC must retain and exercise jurisdiction over maximum rate reasonableness. In accordance with the original interpretation of "market dominance," the ICC should base its jurisdictional findings only on the availability of competition for the transportation of the product at issue along the route at issue. Furthermore, the determination of revenue adequacy should be based on consideration of all relevant financial criteria. It is SPI's belief that all of these measures will encourage intra-rail competition and otherwise further the objectives of the Staggers Act.

Statement of Fred Sohn, President of Sun Studs, Inc.

My name is Fred Sohn, President of Sun Studs, Inc. and Sun Plywood, Inc. We operate lumber, veneer and plywood mills in Roseburg and North Bend, Oregon. We employ approximately 450 people in these two communities. Our annual production is 90 million board feet of lumber, 220 million square feet of veneer and 120 million square feet of plywood.

The purpose of these hearings is to determine if the goals of the Staggers Act are being met.

First, the goals which have been met. Today, thanks not only to the Staggers Act, but also to the Tax Reform Act of 1981, the railroads have regained their financial strength and are once again a strong segment of our economy. On this note those who drafted and implemented the Staggers Act are to be commended. But as in the laws of physics, so in the economics of transportation, "for every action, there is an equal and opposite reaction". In many areas the Staggers Act has failed!

Where are those failures? They are at the heart of the transportation system. Do rail carriers fulfill their charter to provide carriage of the goods of this country on a fair and equitable basis? In many cases the answers to this question is an emphatic NO!!!

We market our products throughout the United States, but today we are limited to a smaller area because of inroads other producing areas are making in our markets. Since the passage of Staggers, the railroads have completely within their power the ability to say which shippers will be in certain markets; their mechanism—the secret contract.

Prior to Staggers all producers in a given region would have the same freight rates to the same markets; but with the advent of "secret contracts" one producer can gain a substantial advantage over the others in his area. They accomplish this by committing substantial volumes of traffic to the rail carrier and using the leverage that they have from other producing areas with the carrier to protect their facilities that are located at non-competitive points. We are at a non-competitive point served by only one carrier. We do not have other facilities to use as leverage with the carriers. How can a small, independent producer compete with the large vertically integrated multi-facilitied conglomerates? Competing with these firms is hard enough for us—we must have transportation parity! I do not think it was the intention of Congress to force us out of our markets when it passed the Staggers Act.

Another crippling factor in this equation is that when several producers are competing for timber sales in the same region, a secret contract can be devastating when it is translated back into what one can do in competition for the sale. Let me outline a scenario which might develop. Neighboring mills competing for timber in the same area on auction bid rules: the mill with a substantial freight advantage of twenty dollars per thousand due to contract rates would automatically have a forty dollar per thousand advantage with is neighbor in purchasing timber, based upon standard recovery in a modern sawmill today.

What does this do for the small independent business? It restricts markets and the ability to continue in operation. This eventually leads to their demise and the loss of jobs in our communities. This cannot be allowed to continue. There is a simple solution.

There must be full disclosure of all information in rail contracts. Currently there is only summary disclosure on non-box car traffic and by the time someone can react (you only have 18 days) the contract is in effect and cannot be challenged. Those who have challenged contracts have only been rejected by the ICC which has gone from a role of a consumer advocate with the carriers to a carrier advocate with the consumers. Box car traffic under contract is completely disguised and cannot be challenged for any reason. The box car exemption promulgated by the ICC in Ex Parte 346 makes this virtually impossible. As the bigs get bigger, it seems to me that they are beginning to corner markets and one might wonder if they should be investigated to determine if any anti-trust areas are being violated.

We do not say these things without attempts on our part to work within the framework of the existing structure. We have tried and every time we have been rejected. We have tried to assemble groups of shippers, but carriers have been unwilling to work with us. We have approached carriers with contracts for ourselves and are only told that they have no contracts, yet every day we run into them in the marketplace when our competitors delivered costs are below ours. This abuse can no longer be tolerated!!!

The American Railroad has contributed to the trade deficit of this country by contracting with Canadian Railroads to make the Canadian shipper more competitive. Example: On November 4 the Burlington Northern and the Canadian British Columbia Railways agreed to a rate structure that allows the Canadian mills in British Columbia to ship California and Arizona destinations at a cost reduction of two thousand dollars per car. Approximately twenty dollars per thousand. To compete the Oregon, Washington and Northern California mills will be forced into a devastating drop in prices. This is an example of how our Canadian competitors have been able to saturate our markets.

INDIANA MUNICIPAL ELECTRIC ASSOCIATION, INC.,
Tipton, IN, October 28, 1985.

Hon. BOB PACKWOOD,
U.S. Senate, chairman, Senate Subcommittee, Surface Transportation, 259 Russell Senate Office Building Washington, DC.

DEAR SENATOR PACKWOOD: Two major problems have arisen under the implementation of the Staggers Rail Act of 1980. Certain railroad practices have resulted in reduced competitive options for shippers and the ICC's rulings and interpretations have ignored protections for captive shippers that were provided by Congress, leaving consumers and shippers that are subject to railroad monopoly power defenseless against excessive rail rates. The Indiana Municipal Electric Association supports the aims and the purpose of the Staggers Rail Act of 1980 (Act) as envisioned by those who worked hard to write protection for captive shippers. We are however, concerned about its implementation. The major victims of any failure to implement the Act in a balanced manner, balancing the needs to shippers, carriers and the public, are our electric utility consumers.

Under the ICC's implementation of the Act, there appears to be no upper limit to the price railroads can charge the utility that has no realistic transportation alternative. While we recognize the national interest in strong, financially healthy railroads, we believe carriers and shippers who are subject to railroad monopoly power deserve effective protection against the unrestricted exercise of that power. The reduced competiton in shipping and the resulting monopoly power of railroads in setting certain rail rates is a serious problem facting the American economy. This situation is affecting the price of electricity to our consumers, the price that farmers receive for their goods, our ability to market coal, agricultural products and manufactured commodities in both domestic and world markets, and job secutiry of many of our workers.

We are convinced that the protection the Consumer Rail Equity Act of 1985 encourages will be beneficial to us all. The changes proposed by S. 477 can preserve the benefits of competitive access for all and give captive shippers a fair chance to challange unreasonable rail rates at the ICC. The legislation also increases opportunities for competition between railroads by requiring the use of agreements for joint rates and reciprocal switching if necessary to assure competition.

We encourage your Committee to hold legislative hearings to allow the embodiment of these reforms into the Act.

Sincerely,

PAUL W. OSLER, *Executive Director.*

THE PITTSBURGH & LAKE ERIE RAILROAD CO.,
Pittsburgh, PA, October 30, 1985.

Mr. HAROLD L. GASTLER,
President, Missouri-Kansas-Texas Railroad Co.,
Dallas, TX.

DEAR HAROLD: I have had an opportunity to review a copy of your testimony before the Senate Commerce Committee which I understand you will present for Railroads Against Monopoly ("RAM") on November 4, 1985, in Washington, D C. On behalf of The Pittsburgh & Lake Erie Railroad Company, I endorse your comments and urge the Senate Commerce Committee to give your testimony full and careful consideration.

As you are aware, the mass cancellation of competitive, efficient joint rates and routes by the large trunk line railroads has seriously reduced competition within the railroad industry. The Pittsburgh & Lake Erie Railroad Company has been seriously injured by the indiscriminate, blanket cancellation of joint rates and routes by Consolidated Rail Corporation. We are presently involved in litigation before the Interstate Commerce Commission and the United States Circuit Court of Appeals for the District of Columbia contesting the legality of these blanket rate cancellations.

I have also reviewed the RAM Group legislative proposal which is attached to your Congressional testimony. P&LE supports this legislative measure and is committed to its introduction and adoption by the Congress. P&LE believes that the Interstate Commerce Commission has failed to implement the intent of the Staggers Rail Act of 1980. It has failed to protect and promote interrailroad competition as that Act envisioned. We have attempted to resolve competitive access issues before the Interstate Commerce Commission only to be rebuffed repeatedly by the Commission's insensitivity to the concerns of regional railroads and its total preoccupation with the revenue adequacy of the major trunk line carriers. P&LE has concluded that the only way to change this regulatory myopia is for Congress to direct the ICC to preserve and encourage interrailroad competition through the specific, efficiency oriented joint rate standards contained in the RAM legislative proposal.

Again, let me state that the P&LE supports your testimony before the Senate Commerce Committee and shares your commitment to a competitive rail transportation industry.

Sincerely yours,

RICHARD E. THOMPSON, *President.*

CHICAGO BOARD OF TRADE,
Chicago, IL, October 31, 1985.

Hon. JOHN C. DANFORTH,
Chairman, Senate Committee on Commerce, Science, and Transportation, Dirksen Building, Suite 508, Washington, DC.

DEAR SENATOR DANFORTH: Regarding the upcoming oversight hearings on implementation of the Staggers Act, to be held on November 1 and 4, the Chicago Board of Trade (CBOT) wishes to go on record in support of the Consumers United for Rail Equity (CURE) proposed amendment to Section 7(a) of the CURE Bill.

The CBOT feels that legislation is needed to insure an increase in intramodal competition and one sure way of achieving this goal is through the enactment of mandatory proportional rates.

We look upon the proportional rate concept as a valuable tool in ratemaking, particularly for captive bulk shippers located on a single rail line, interested in merchandising their commodities where two or more rail lines would be available to reach their final destination. It has been our experience, that even though combination rates are available, it has been the policy of the line-haul carrier to dictate the point of interchange for the purpose of generating longer haul revenues for themselves. This practice precludes both delivering carrier, who is usually a shortline carrier, from achieving its optimum revenue return, and the bulk shipper, from its right to route a shipment to achieve its greatest potential of transportation cost savings. In addition, this type of dictated routing by line-haul carriers is in some cases fuel inefficient. Moreover, this reduces the competitive advantage of a shipper in determining its own route of shipment at the most cost-efficient transportation charges which is available.

It is for this reason that CBOT wishes to support Section 7(a) of the CURE Bill. However, if we may suggest, we would prefer a five day time limitation on the carriers compliance with a request for proportional rates, and in addition, a vehicle to be included in the bill to insure the shipper receipt of costing figures by the railroad for the purpose of determining the railroads division when requested, within a reasonable time.

The CBOT respectfully requests you consider our support of Section 7(a) of the CURE Bill and additional suggestions we offer.

Very truly yours,

JOHN R. DOBRZYNSKI,
Manager of Transportation.

THE LIGHT COMPANY,
HOUSTON LIGHTING & POWER,
Houston, TX, October 31, 1985.

Hon. BOB PACKWOOD,
Chairman, Subcommittee on Surface Transportation, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, DC.

DEAR CHAIRMAN PACKWOOD: Houston Lighting and Power Company thanks you for holding oversight hearings on the implementation of the Staggers Rail Act. The problems which were described in Senator Danforth's resolution from the last Congress still exist and need to be addressed. During the course of these hearings, we believe that you will also confirm this.

The Staggers Rail Act of 1980 has been very effective in freeing the railroad industry from unnecessary government regulation and subjecting it to the rigors and opportunities of the open market. In particular, the provision allowing railroads and rail shippers to enter into contracts has been enormously successful. Unfortunately, in those situations where competition does not exist—where market prices cannot be relied upon by rail shippers to obtain needed transportation services at reasonable costs—the implementation of the new law by the Interstate Commerce Commission has completely deprived monopolized shippers of the protections Congress intended them to have. In individual cases and general rulemaking proceedings, the ICC has consistently ignored Congress' direction that the agency balance the needs of shippers, carriers and the general public. In its resolution of certain key issues the ICC has:

Defined the concept of "Revenue adequacy," its lodestar for rail carrier rate freedoms, in a way which bears little resemblance to credible indicia of financial health used throughout the financial community, and which produces results wholly at odds with reality: e.g., both Burlington Northern, which shelled out over $700 million in cash for Texas Gas Resources, and Norfolk Southern Corp., which with $1.2 billion in cash, is touting its financial health in its bid to buy Conrail, are classified as woefully "revenue inadequate" by the ICC.

Devised a set of guidelines for maximum rates which would allow a carrier to price traffic over which it has a monopoly at any level up to the shipper's cost of owning and operating its own railroad. As interpreted by the railroad industry in individual cases, this standard would permit rates in excess of 500% of the railroads' cost of service.

Established quidelines for determining "market dominance" which require shippers to engage in complex, protracted and expensive antitrust-type proceedings simply to establish ICC jurisdiction to examine the reasonableness of rail rates.

Effectively nullified the fundamental jurisdiction of states over commerce wholly within their borders, requiring all states to march in lock-step with the ICC on every matter involving railroad rates and service.

Permitted arbitrary and anti-competitive cancellations of joint rates and closings of through routes, enabling carriers to divide markets and consolidate market power, reducing shipper options and exacerbating the potential for monopolistic pricing.

The problem lies not in the fundamental structure of the Staggers Act, but rather in the lack of firm guidance as to its implementation by the ICC. Congress' role is to further clarify its original intent, and give strong direction to the ICC in order to ensure that that intent is fulfilled. In particular, legislation is needed to:

Require the ICC, in determining revenue adequacy, to adhere to a policy which realistically evaluates the railroads' financial posture.

Require establishment of standards for rail rates which afford some reasonable protection to captive rail shippers against excessive rates.

Clarify and simplify the requirements which rail shippers must satisfy to establish ICC jurisdiction to review rail rates on monopoly traffic.

Restore to the states their traditional authority, in the first instance, over intrastate commerce, and restrain the ICC from exceeding the proper bounds of appellate review of state agency determinations.

Prevent carrier abuse of the power to cancel joint rates or close through routes so as to ensure that such activities are not carried out with anticompetitive impact.

The Consumer Rail Equity Act, S. 477, was introduced by Senator Mark Andrews of North Dakota on February 20 of this year to accomplish these goals. While retaining the basic structure of existing law, this bill seeks to restrict the ability of the Interstate Commerce Commission to restrict the ability of the Interstate Commerce Commission to ignore the intent of Congress in several key areas, such as revenue adequacy, rate reasonableness, and market dominance.

Houston Lighting & Power Company supports the efforts of the Consumers United for Rail Equity. We ask for legislative hearings on the Consumer Rail Equity Act and that the committee favorably report S. 477.

Sincerely,

Howard Pyle.

Grand River Dam Authority,
Vinita, OK, November 5, 1985.

Senator Bob Packwood,
Chairman, Subcommittee on Surface Transportation, U.S. Senate, 259 Russell Senate Office Building, Washington, DC.

Dear Senator Packwood: I am writing this letter to affirm our support of the Staggers Act. However, there are some problems with the implementation of the Act, as interpreted and enforced by the Interstate Commerce Commission, as it relates in particular to shipment of coal from the Powder River Basin in Wyoming to our coal-fired power plant at Chouteau, Oklahoma.

Grand River Dam Authority is a captive shipper. We currently have only one railroad (Burlington Northern) serving the mines from which we purchase coal in the Powder River Basin and one railroad (Missouri-Kansas-Texas) serving our power plant at Chouteau, Oklahoma. The Stagger Act as construced by the Interstate Commerce Commission provides no protection for us from monopoly pricing by the two railroads. We are pretty much at their mercy in negotiating a contract for the haulage of coal.

We are members of Consumers United for Rail Equity and support their activities in securing passage of the Consumer Rail Equity Act. It is our belief that this will not substantially alter the Staggers Act, an Act which we fully support, but that it will make the minor changes necessary for the Act to provide a level playing field for negotiations between captive shippers and the railroads.

We request that you hold a legislative hearing on the Consumer Rail Equity Act so that you and your subcommittee might more fully explore the difficulties experienced by captive shippers and equip yourselves better to assess the merits of the rather minor changes proposed under the Consumer Rail Equity Act.

Sincerely yours,

James G. Ekstrand,
Assistant General Manager.

American Mining Congress,
Washington, DC, November 13, 1985.

Hon. Bob Packwood,
Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, DC.

Dear Senator: The American Mining Congress is pleased that oversight hearings on the Staggers Act have begun. We welcome the opportunity to provide you with our views on the effect of the Staggers Act on the mining industry and respectfully respect that this letter be included in the hearing record.

The American Mining Congress is an industry association that encompasses (1) producers of most of America's metals, coal, and industrial and agricultural minerals; (2) manufacturers of mining and mineral processing machinery, equipment and supplies; and (3) engineering and consulting firms and financial institutions that serve the mining industry.

The following statement on Transportation was adopted September 21, 1985, as a part of our Declaration of Policy:

TRANSPORTATION

As a major shipper of bulk commodities to domestic and foreign markets, the mining industry is vitally concerned with all modes of transportation and their development, modernization, efficiency, and costs.

A. Rail Rates for Captive Shippers

The American Mining Congress regards the most serious transportation problem to center on the railroads and the lack of restraint on their power to set rates, particularly for captive coal traffic.

Although Congress substantially deregulated railroads in 1980, it provided that where a railroad held a transportation monopoly, the Interstate Commerce Commission (ICC) should prevent its abuse of "market dominance."

We believe the ICC has failed to do this; instead it has been excessively devoted to improving the financial condition of these railroads, largely ignoring the need to protect their captive shippers against monopoly pricing.

We support the goals and recognize the successes of the legislation that was meant to deregulate and rehabilitate America's rail system in order to meet the needs of interstate commerce and national defense, but we deplore the failure to adhere to another objective of the legislation, which was to promote competition and prevent abuse of captive shippers. The ICC policy and decisions violate congressional intent.

The American Mining Congress supports administrative actions, legislative alternatives and possible litigation to reach the goal of balance in meeting the needs of rail carriers and shippers alike.

Specifically, we support legislation that (i) requires the ICC to employ a definition of market dominance which has, as its sole focus, the lack of transportation competition, a condition inherent to many mining properties; (ii) requires a railroad to prove that its rates are reasonable and do not require captive shippers to pay more than their fair share; and (iii) prescribes a realistic method of determining "railroad revenue adequacy" that relies on the broad array of accounting indicators normally used to assess the financial health of a company or industry. AMC does not support legislative efforts that would seek to "reregulate" railroads by undoing the provisions of the Staggers Act that promote deregulation where transportation competition exists and encourage railroads and shippers to contract for transportation services.

AMC also supports the principle of subjecting railroad monopoly power to meaningful antitrust scrutiny to ensure that railroads do not abuse a market dominant position by denying captive shippers competitive rail service.

We also support private and public actions to increase competition in the transportation of bulk commodities. The maintenance of Conrail as a separate entity will promote competition among railroads for the transportation of minerals moving in the midwestern and eastern United States served by Conrail, and between these areas, and southern and western states. AMC therefore supports the return of Conrail to the private sector through a viable public stock offering. The advent of the new Chicago and North Western rail line, as well as the potential of coal slurry pipelines, offers additional opportunities to improve competition and help control rail rates.

In addition, we support Staggers Act provisions, including contract authority, that permit coal producers and carriers to market aggressively their products and services.

B. Other Concerns

Of course, rail is not the sole mode of transportation of keen concern to the mining industry. The nation's ports, as well as the Great Lakes and the inland waterways, are also essential components of the transportation system.

We believe the federal government has primary responsibility for the ordinary operation and maintenance of the nation's waterways and therefore oppose any user fees or charges for such purposes. We urge that appropriate actions be taken to improve waterways facilities to enhance commerce and increase U.S. export competitiveness. We oppose the concept of cargo preferences.

Finally, the American Mining Congress supports the present heavy reliance upon competition in the trucking industry, with appropriate regulation and enforcement of adequate safety measures.

If we can be of further assistance to you, please call upon us.

Sincerely,

J. ALLEN OVERTON, Jr., *President.*

American Paper Institute, Inc.,
New York, NY, November 13, 1985.

Hon. Bob Packwood,
Chairman, Surface Transportation Subcommittee, Committee on Commerce, Science and Transportation, U.S. Senate, Russell Office Building, Washington, DC.

Dear Mr. Chairman: In conjunction with the November 1 and 4 oversight hearings pertaining to the Staggers Rail Act, we wish to present the views of American Paper Institute, Inc. (API), the national trade association of the pulp, paper and paperboard industry and ask that they be included in the record of this proceding. API is comprised of approximately 175 companies engaged in business, including converting operations, in all States of the Union. The members of this industry are substantial users of railroad transportation. Our industry is one of the most important customers of the nation's railroads.

This statement is also concurred in and supported by the American Plywood Association and the American Pulpwood Association.

API actively participated in the hearings before the Subcommittee and the Committees for the Congress which led to the enactment of the Staggers Rail Act of 1980 (SRA). API has participated in and is participating in most, if not all, the major proceedings before the Interstate Commerce Commission implementing SRA. As indicated in its testimony before the Congress, API strongly supported SRA and its objectives of achieving maximum deregulation of the railroad industry with the proviso that there should be regulatory protection for those who are confronted with railroad monopoly power and the possible abuse of carrier market power.

API is aware of the fact that legislation such as S. 477, described as the Consumer Rail Equity Act, has been introduced, the objective of which is substantial modification of SRA.

As is to be expected, there have been honest disagreements between railroads and shippers as to the proper implementation of SRA. A number of these issues have been litigated before the Interstate Commerce Commission and before the Federal Courts. This process has resolved several of the contested issues. Some still remain.

API has noted with satisfaction the process which has been underway whereby such remaining issues have been the subject of negotiations between the interested and affected parties under the auspices and with the encouragement of the Interstate Commerce Commission. API has actively participated in these proceedings and is intimately aware of the developments which have occurred. We refer, for example, to ICC Docket Ex Parte No. 456, The Staggers Rail Act of 1980—Conference of Interested Parties. In that proceeding extensive and intensive negotiations occurred between shippers and receivers on pivotal subjects such as Railroad Competitive Access; Jurisdiction—Railroad Market Dominance—Exemptions; Railroad Revenue Adequacy—Maximum Reasonableness—Rates and related subjects. Out of those proceedings, under the auspices of the Commission, some agreements have been reached between most of the railroads and certain large, responsible shipper groups, presenting the bases for proposed rules to be adopted and made effective by the ICC. Provision has been made for notice in the Federal Register and the right and opportunity of all affected to participate. Two such current proceedings are Ex Parte No. 445 (Sub. No. 1), Intramodal Railroad Competition and Ex Parte No. 320 (Sub. No. 3), Product and Geographic Competition. API is an active party to both these proceedings. The Commission has held "open meetings" in both of these proceedings and has orally announced its determinations as to the issues involved Written decisions of the ICC are expected in the near future. It is the expectation of API that from both of these proceedings will emanate ICC-approved rules governing the subjects indicated which will go far to eliminate or minimize problems which have existed between the railroads and the shippers.

In Ex Parte No. 456, when the Chief Administrative Law Judge of the Commission certified the issues of the Commission he made it clear that the Commission supported the efforts of those concerned to arrive at mutually agreeable resolutions of issues and that the Commission would remain a forum to encourage and to promote such negotiations. Thus there is every reason to hope that other major issues outstanding will ultimately be resolved on a mutually satisfactory basis between the railroads and the shipping public, subject to review and approval in rulemaking proceedings by the ICC.

In the light of all this, API sees no reason at this time for adopting amendments to the Staggers Rail Act of 1980. Rather, API supports the approach embodied in Senate Joint Resolution 331, 98th Congress, Second Session introduced by Senator Danforth and Senators Ford, Kassebaum, Jepsen, Exon, Kasten, Grassley, and Dole. This Joint Resolution clearly contemplates that whatever problems may remain with the implementation of the Staggers Rail Act can and should be resolved by administrative action of the Interstate Commerce Commission. API strongly favors and supports this approach. S.J. Resolution 331 is specific as to what the Congress had in mind in enacting the Staggers Rail Act of 1980 and sets forth its expectation that the Interstate Commerce Commission will take meaningful steps to achieve those Congressional objectives. API has every expectation and hope that the Commission would act in a constructive and forthright manner.

A comparable resolution thus far has not been introduced in the current Congress. It is our understanding that you and the other sponsoring Senators are awaiting the outcome of the Commission proceedings we have mentioned before determining whether it is necessary or appropriate to introduce a similar Joint Resolution in this Congress. At the heart of Senate Joint Resolution 331 is concerned with the issues pertaining to competitive access, market dominance and revenue adequacy.

API wishes to record its emphatic and specific objection to the so-called CURE bill, S. 477 and more particularly to the provisions of Section 4 on the subject of Rate Reasonableness. Were these provisions to be adopted there would be a radical reversal of the presently healthy trend toward deregulation. There would be a substitution of complex regulatory proceedings which in the past have, to many, been regarded as the bane of ICC regulatory experience. Adoption of this Section 4 would be an enormous step backward.

Reports reach API that the proponents of the CURE bill are now suggesting substantial changes in their previous legislative proposal. API is not privy to those changes. We express the hope that such changes will advance the public interest and do not contemplate re-regulation of the railroads or objectives contrary to the stated goals of the Congress in enacting the Staggers Rail Act. The aim should still be continuing deregulation of the railroads, always with the proviso that the shipping public—and especially captive shippers—must be protected from the actual or potential abuse of railroad monopoly power. The latter should be achieved with minimum burden upon the shippers and carriers involved. The ultimate objective is reliance upon the competitive forces of the market place to the fullest possible extent.

CONCLUSION

Having the benefit of observing the implementation of the Staggers Rail Act for almost five years, the balance struck by the Congress in effecting deregulation to the fullest extent possible and in giving the Commission regulatory responsibility as to the remainder has worked out extraordinarily well. Another indication of the sound concepts of the Staggers Rail Act is the demonstrated ability of important segments of the railroad industry and the shipping public to reach agreement as to rules which should govern in such spheres as competitive access and railroad market dominance. API stresses that every person affected is given full opportunity to present to the Commission their views on these proposals. This is a healthy development. It should be allowed to run its course. There is simply no demonstrable need for a rush to re-regulation of the railroad industry.

The principles embodied in Senate Joint Resolution 331 in the last Congress offer a meaningful safety net. If the voluntary negotiations should conceivably not be productive, and API believes they will be productive, the Congress has the option to enact and implement the principles of Senate Joint Resolution 331, a constructive alternative to radical surgery upon the Staggers Rail Act of 1980. The Staggers Rail Act has produced an almost miraculous improvement in the state of the nation's railroad industry. That kind of progress should be maintained and not discarded.

API appreciates the opportunity on behalf of itself, American Plywood Association and the American Pulpwood Association, to present views in strong endorsement of the Staggers Rail Act in its present form.

Sincerely yours,

ROY E. OLSON,
Vice President—Transportation.

WESTERN GOVERNORS' ASSOCIATION,
Denver, CO, November 13, 1985.

Hon. BOB PACKWOOD,
Chairman, Subcommittee on Surface Transportation, Senate Committee on Commerce, Science, and Transportation, 428 Hart Office Building, Washington, DC.

DEAR SENATOR PACKWOOD: This letter and the enclosed policy resolution are being submitted for the record as part of the Subcommittee on Surface Transportation's oversight hearings on the Staggers Rail Act of 1980. As you will note, the western governors affirm that the Act has made a valuable contribution to the current financial well-being of the nation's railroads. A concern is expressed, however, that the goal or restoring financial health to the railroads should not be attained at undue cost to any economic sector or class of shipper, and that no shipper should be charged disproportionately high rail rates because of limited access to competitive rail service.

Over the past year the Western Governors' Association has monitored western rail transportation and the effects deregulation has had on resource development. In April, we released a report entitled "Rail Transportation of Western Coal". This report concluded that there is no practical alternative to rail shipment for most western coal producers, and that there is little competition between railroads for western coal traffic. As stated in the report ". . . for all practical purposes these western railroads enjoy a monopoly market for shipment of coal out of the region."

The cost of rail shipment accounts for up to 75 percent of the delivered price of western coal and nearly three-fourths of the region's coal moves to market by rail. A small percentage increase in transportation costs can render this coal non-competitive, particularly for electric power generation. Such rate increases cause utility purchasers to consider substitutiing less environmentally acceptable high sulfur domestic coal and/or the purchase from foreign sources, thereby displacing domestic suppliers.

Coal is not the only resource whose future is captive to rail transportation rates. For example, Wyoming shippers of trona, a mineral used to manufacture soda ash, recently had to resort to trucking their product 200 miles to a Burlington Northern rail connection. The circuitous routing and added handling was less expensive than paying the captive shipper rates offered by Union Pacific, whose track runs much closer to the shipper' operations. Similar examples of captive shipper problems have been experienced by grain shippers.

As the enclosed resolution states, the governors support deregulation but are discouraged with how the Staggers Act has been implemented by the Interstate Commerce Commission. The Act intended to balance the needs of shippers with those of the rail carriers. The ICC's interpretation of Congress' intent on issues such as market dominance and captive shippers, reasonableness of rates, revenue adequacy, joint rates, through routes, reciprocal switching, contracting procedures and adequacy of competition does not reflect the spirit of this balance.

The governors continue to urge the ICC to take action to redefine captive shipments in its regulations to make clear a rail shipment is captive unless an economical alternative means of transportation is available. Should the ICC fail to act by February 15, 1986, the governors then urge Congress to consider measures for addressing these problems.

Thank you for the opportunity to include the western governors' resolution in the record of these proceedings. I will be happy to provide additional information on this subject to the Subcommittee on request.

Sincerely,

PAUL M. CUNINGHAM, *Executive Director.*

THE COLORADO MINING ASSOCIATION,
Denver, CO, November 15, 1985.

Hon. BOB PACKWOOD,
Chairman, Subcommittee on Surface Transportation,
Senate Russell Office Building, Washington, DC.

DEAR SENATOR PACKWOOD: I am writing this letter as President of the Colorado Mining Association about our growing concern over the use of railroad monopoly power. We were pleased to learn of the recent hearings you held with regard to implementation of the Staggers Act and request that this letter be made a part of that record.

The Colorado Mining Association has over 1,800 members and a proud history that began in 1876. Colorado's mining industry has provided a mainstay for the State's economic base throughout its history. Railroads were very much a party of that history and good rail service, that is fairly priced, remains vital to our immediate and long range future. This is particularly true with regard to coal production.

Colorado coal production and rail transportation are inextricably linked since our coal has no practical atlernative to rail transportation. Not only is there no intermodal competition for long hauls from Colorado mines, in most cases there is no intramodal or rail competition either. Producers and shippers, in most instances, are captive to one or another of a few large rail systems which, through a series of mergers and consolidations, now dominate the industry.

Rail transportation charges are a critical factor in determining the price competitiveness of Colorado coal in the interstate market and a major determinant in the future vitality of our coal industry. This is especially true since the utility coal market is highly price sensitive. Even slight increases in delivered price of coal can tip the balance away from a given supplier.

As prices increase, the distance Colorado coal can penetrate markets shrinks. Data developed for Consumers United for Rail Equity show an average rate increase of 62% for Colorado coal shipped to out-of-state markets from 1979 through 1983. These increases have had a devastating affect on Colorado coal production.

Central Illinois Light, for example, shifted from Montana and Colorado coal to eastern Kentucky and southern West Virginia low sulfur supplies. The shift was directly related to rail costs. In a similar case, Central Power and Light of Corpus Christi, Texas, has advised Colowyo Coal that because of the delivered price of the Colorado coal, the utility will be phasing out its purchases over the next ten years.

Of the state's 57 permitted coal mines in 1981, only 37 remain active today. And, the active mines are only operating at 48 percent of capacity. Sagging demand for electricity and the decline in price for competitive fuels contribute to the soft coal market. However, high transportation costs are viewed as the major cause of the rapid decline in Colorado coal production. Neither Colorado coal producers nor their customers have confidence that the Interstate Commerce Commission has offered or is likely to offer meaningful protections to captive shippers. One only has to look at the performance of the ICC since the adoption of the Staggers Act to know that serious problems exist that merit Congressional attention. Four major problems are outlined below:

REVENUE ADEQUACY

The ICC's methodology for measuring the revenue adequacy of a rail carrier ignores all indicators of financial health except one: whether the carrier is earning a return on its net investment equal to the current cost of capital. Moreover, the "investment base" defined by the ICC includes inflated tax and debt service expenses, unused and non-useful assets, and over valued property accounts. As a result, every Class I rail carrier is deemed to be "revenue inadequate," in spite of the fact that many are engaged in expensive, internally-funded acquisition and diversifications and are touted as sound long-term investments by financial analysts.

STANDARDS FOR RAIL RATES

In measuring maximum reasonable rates, particularly in connection with movements of captive coal traffic, the Commission has elevated revenue adequacy to the principal, if not sole, goal to be achieved. Additionally, the Commission has effectively nullified the captive shipper protections built into the Act by the Long-Cannon Amendment imposing impossible burdens of proof and data production on shippers and refusing to consider the Amendment's criteria unless the burden is met. The result has been that since enactment of the Staggers Act, the Commission has yet to render a final decision finding a single captive coal rate to be in excess of a maximum reasonable level, notwithstanding proof that many rates are in excess of 300% of the carrier's cost of service.

RAIL MARKET DOMINANCE

The ICC has interpreted the jurisdictional concept of "market dominance" in a fashion which requires shippers and carriers to submit voluminous evidence of the existence of potential, indirect product and geographic competition, in addition to the direct transportation competition which was the focus of Congress' concern. The result has been to turn what was intended as a threshold jurisdictional determination into a complex, antitrust-type proceeding under a set of nebulous guidelines which are unpredictable and effectively preclude the "practical determination without delay" envisioned by Congress.

TRACKAGE RIGHTS

In many instances, shippers which are presently captive to a single railroad could avail themselves of transportation competition if they (or a competing carrier) could obtain the use of portions of the dominant carrier's lines. Under existing law, however, the ICC is empowered to grant such "trackage rights" only in terminal areas (or over main lines for a reasonable distance from a terminal).

Most Colorado coal producers do not have the resource to fight their way through the regulatory process set out by the ICC. With the likelihood of success being what it is, we feel the system must be changed.

The recent hearings you held are a first step and are greatly appreciated. But please don't stop now. We hope you are convinced that the issue needs further Committee scrutiny around a specific legislation. The Consumer Rail Equity Act (S.477) addresses some of the concerns we have over the implementation of the Staggers Act and would achieve the balance originally contemplated in the Staggers Act. The Colorado Mining Association respectfully requests that you consider scheduling hearings around that legislation.

Sincerely yours,

David R. Cole, *President.*

Statement of William J. Augello, on Behalf of The Shippers National Freight Claim Council, Inc.

My name is William J. Augello, Executive Director and General Counsel to the Shippers National Freight Claim Council, Inc. The Council is a nationwide, nonprofit trade association of over 750 shippers, receivers, carriers, insurers and others interested in carrier liability, freight claim and freight charge issues.

We appreciate this opportunity to present this statement at the conclusion of the five-year oversight period established to monitor the results of The Staggers Rail Act of 1980.

Our statement is confined to the carrier liability aspects of The Staggers Act. Unfortunately, we must report to Congress that *the railroad industry in general has not responded in a responsible manner to the freedoms created by The Staggers Act with respect to their liability for loss, damage or delay to goods in transit, or with respect to the time limit for filing overcharge claims.*

A. HISTORY IS REPEATING ITSELF

Since the deregulation of the railroad industry in 1980, shippers have been experiencing the same liability problems produced by railroad managements' attitudes and policies in the late 1890's and early 1900's.

To illustrate, we have annexed a brief review of the conditions which led to the regulation of the railroad industry in 1887, as Appendix A.[1]

With rrspect to liability for loss, damage and delay, Congress enacted the Carmack Amendment as a part of the Hepburn Act of June 29, 1906. The history of this Act, which has served as the cornerstone of common carrier liability ever since then, is reviewed in Appendix B.

The Carmack Amendment was intended to rectify the railroad industry's policies designed to evade liability for the negligent loss of or damage to shippers' goods in transit. It made the initial and delivering carrier on an interline movement jointly and severally liable, thus ending the inconvenience to which shippers were subjected in suing each connecting carrier between origin and destination.

This law made all common carriers liable for the "full actual loss", and made unlawful all attempts to limit railroad liability by contract, receipt, tariff rule, regulation or by any other means. It also established a uniform minimum time limit for filing claims and suits, thus bringing order to the chaos created by the application of different state statutes of limitations to shipments moving in interstate or foreign commerce.

At this juncture, the Interstate Commerce Commission's analysis of common carriers' claim policies is significant to the current liability situation. In its landmark decision in Ex Parte 263, *Rules, Regulations and Practices of Regulated Carriers With Respect to the Processing of Loss and Damage Claims*, 340 I.C.C. 515 (1972), the I.C.C. stated:

"Complications in the processing of claims against carriers . . . arose when the Supreme Court held in *Adams Express Co.* v. *Croninger*, 226 U.S. 491, 509–510 (1913), that a carrier could under the Carmack Amendment 'by a fair, open, just and reasonable agreement limit the amount recoverable by a shipper in case of loss or damage to an agreed value made for the purpose of obtaining the lower of two or more rates or charges proportioned to the amount of the risk * * *'. Following the *Croninger* case and other similar court decisions, many railroads began to publish prohibitively high rates based on actual values of commodities shipped. The net result of this was that shippers had no effective choice of rates and were denied full and fair recovery for shipments lost or damaged in transit.

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[1] The appendices have been retained in the Committee files.

"Inasmuch as common carriers are liable as carriers and bailees, they are fully responsible for the consequences of their own negligence or want of skill and also for whatever else may happen (save the above exceptions and those applicable only to water carriers) to the property while it is in their possession. The rigid liability thus imposed may not arbitrarily or unilaterally be avoided by the carrier, but it may be limited for a consideration provided we give our prior approval under the released rates provision section of section 20(11) of the act. Even so, the problems of carriers attempting to limit their liability arbitrarily and by other means seem to have continued almost unabated. The rules adopted by rail and motor carriers and freight forwarders * * * which prompted the filing of the petition in Docket No. 35198, and the other relevant carrier practices with which we are concerned in this proceeding, appear to represent the latest efforts by carriers in this time-honored endeavor."

B. CURRENT RAILROAD LIABILITY SCHEMES

As a result of the freedoms granted in The Staggers Act of 1980, railroad management has reverted to its nearly 100-year old liability schemes, and with great success.

The A.A.R. reported claims payments for 1984 to have been reduced 50%, from $324,513,612 in 1980 to $160,990,950. This substantial savings in expense was made possible by statutory changes in liability standards and by inventive management strategies, at the expense of the shipping public, to the tune of $160 million a year.

Furthermore, much of the reduction in claim payments was made possible by unlawful exculpatory clauses in railroad tariff rules and claim policies.

In the following sections, we will describe the exonerating rules and practices which were made possible by The Staggers Act of 1980, and those which were unilaterally introduced by railroad management in contravention of the law.

C. STATUTORY CHANGES IN THE STAGGERS ACT

1. Released rate approvals

The fundamental changes in railroad liability contained in The Staggers Rail Act of 1980 pertained to released rates. Congress repealed the second Cummins amendment of August 9, 1916 which required all limitations of liability to be approved by the I.C.C.

The intent of this 64 year-old statute was to limit the carrier's liability "to an amount not exceeding the value" declared in writing by the shipper, if the shipper opted for a lower rate with limited carrier liability. Thus, the I.C.C standards for approving released rate offerings were abolished, and railroads were permitted to publish released rates at will. Annexed as Appendix C is a copy of a typical railroad list of released rate commodities and their limits as presently maintained in an exempt TOFC/COFC circular.

Thus, shippers lost their former right to administratively contest released rate levels before the I.C.C., and are at the mercy of the railroads with respect to having a realistic choice of limited and full value rates.

2. Automatic released rates

Another fundamental change was in the general rate level maintained by the railroads with liability for full actual loss. When the I.C.C. exempted certain types of rail traffic (produce, TOFC/COFC, boxcar, frozen foods, etc.), the railroads changed the general level of rates to a limited liability basis. Since the law requires carriers to offer full liability in addition to any released rate offerings, the railroads offered to quote a premium in the event a shipper desired full liability coverage.

Stated differently, the railroads switched their general rate level to an "automatic released rate" system which limited their liability without a specific written release by the shipper. "Automatic releases" have been declared unlawful by the I.C.C. Ex Parte No. MC-98 (Sub 2) *Released Rate-Small Shipments Tariff*, 361 I.C.C. 404, 415–417, and *Transconex, Inc.-General Commodities*, Rel. Rate Decision No. FF-305, Oct. 21, 1982. In Ex Parte No. MC-98 (Sub-No. 2), the I.C.C. ruled:

"We agree with the majority that releasing rates ought not to be automatic. The shipper who deliberately signs for released rates is less likely to release the value by mistake than is the shipper whose shipments are subject to released value unless he or she indicates full liability is desired. An accidental release of value could be catastrophic, whereas full value rates may be more easily absorbed.

"Shippers must be able to choose the transportation service which most closely conforms to their needs. A released rates provision can add flexibility to rates and services. However, if the release is automatic, the flexibility of the system could be illusory . . . " 361 I.C.C. at 416, 417.

The courts also have held that a carrier cannot limit its liability automatically or by implication. Instead, "[t]here must be an absolute, deliberate and well-informed choice by the shipper." *Anton* v. *Greyhound Van Lines, Inc.*, 591 F.2d 103, 108 (1st Cir. 1978). As the Second Circuit stated,

"To permit a carrier, without any action whatever by the shipper in respect to valuation in writing, to limit its liability on the basis of declared or released value on which the rate was charged would be to ignore entirely the statutory requirement that the shipper must make the declaration or agreement in writing . . . *Caten* v. *Salt City Movers & Storage Co.*, 149 F.2d 428, 432 (2d Cir. 1945).

A specific "automatic release" maintained by a railroad has only recently been unenforceable by a federal court in *Cooperative Shippers, Inc.*, v. *Atchison, Topeka & Santa Fe Railway Co.*, (D. Ill. No. 84-C-2359, July 3, 1985). The court held that such releases were a "trap for the unwary" which the I.C.C. has previously condemned, and awarded full actual loss to the shipper, stating:

"The problem with this contractual scheme is that it reverses the assumption of liability required by §§ 10730 and 11707. Sante Fe is offering full liability rates, but only as an alternative to otherwise applicable released rates. The automatic nature of Santa Fe's limitation of liability is precisely the "trap for the unwary' that the I.C.C. has refused to allow by requiring carriers to obtain a deliberate release from the shippers. Accordingly, Items 52 and 57 do not comply with §§ 10730 and 11707, and they are unenforceable. 49 U.S.C. § 11707(c)(1); see also *Fruitco Corp.* v. *Consolidated Rail Corp.*, 118 Misc. 1090, 462 N.Y.S.2d 754 (N.Y. Cir. Ct. 1983)."

More recently, a Federal District Court in Virginia held a motor carrier's automatic released rate on used machinery to be unenforceable because the limitation of the carrier's liability to $.10 a pound would apply without the shipper's affirmative declaration of value in writing on the bill of lading. *General Electric Co. & Ins. Co. of N. America* v. *McLean Trucking Co.*, F. Supp. , E.D. Va, Alex Div.) C.A. 85-417-A, Oct 17, 1985.

Previous to these decisions, our courts have not been uniform in interpreting similar automatic releases.

3. No realistic choice of rates

A third problem pertains to the differential between full value rates and limited value rates. The I.C.C.'s jurisdiction to judge the reasonableness of rates was repealed in 1980, except when a railroad is found to have market dominance over a segment to traffic. Thus, shippers have no effective recourse when railroads set the full value rates prohibitively high to discourage their use. This is the same practice discussed by the I.C.C. in its Ex Parte 263 decision, regarding the period following *Adams Express* v. *Croninger*, (1913).

The practice of railroads' holding-out to quote a full value rate, without actually publishing the choice of rates, was held to be unlawful in *Fruitco Corp.* v. *Conrail*, 462 N.Y.S.2d 754 (1983).

Following this decision, the railroads began to publish premiums for full liability, ranging from 5% to 25% of the limited liability rate levels. Such blanket premiums applicable on all rail traffic are in violation of the public policy set forth in *Adams Express*, supra, which requires limitations to be "proportioned to the amount of the risk". Since each commodity shipped has different transportation characteristics, loss factors, and values, a blanket premium on the rate applicable on all products, in return for full value protection, can not meet this test.

Althugh these practices may be unlawful and unenforceable, railroads continue to raise these rules in defense of lawful claims, and generally succeed in avoiding payment due to the cost of litigation. The solution, therefore,, is to codify the common law rules on these issues, and thus induce more strict adherence to the law.

To paraphrase the I.C.C.'s finding in Ex Parte 263, the railroads substitution of automatic release and setting unrealistically high premium rates for full value coverage "appears to represent the latest efforts by carriers in this time-honored endeavor". 340 I.C.C. 515, 524 (1972).

The only real difference between the railroads' tactics in 1913, 1972 and 1980 is that the liability limitations imposed by the railroad industry after 1980 had Congress' sanction. Congress, therefore, must rectify these undesirable results.

4. Deductibles

The fourth problem stems from Congress' provision for railroads to incorporate deductibles in released rates pursuant to 49 U.S.C. §10730(c), annexed as Appendix C-1.

Deductibles have a place in insurance contracts where the property owner retains control of his goods. The owner can weigh the risks involved, thus retaining a portion of that risk through a deductible amount in return for a lower insurance premium.

In a bailment contract, however, the owner surrenders control of the goods to the bailee (carrier), and is at the mercy of that carrier's care and protection. When the parties agree on a limitation of value, such as $.50 a pound, including a deductible of $200 per shipment, for instance, the carrier is completely relieved of all liability for its negligent loss of or damage to the goods up to the amount of the deductible. This is in contravention of one of our fundamental common law rules which prohibit contracts which relieve a common carrier of the consequences of its negligence.

Justice Frankfurter explained this public policy in *U.S.* v. *Atlantic Mutual Ins. Co.*, 343 U.S. 236, 244 (1951) as follows:

"The courts based this reservation upon the observation that such contracts were not in fact consensual agreements. The shipper had little choice but to accept the carriers' terms. See, e.g. *Railroad Co.* v. *Lockwood*, 17 Wall. 357, 379; *Liverpool & Great Western Steam Co.* v. *Phenix Ins. Co.*, 129 U.S. 397, 441. This circumstance did not necessarily void the agreement since many stipulations were upheld. But it provided justification for refusing to enforce those which offended judicially pronounced public policy."

Futhermore, deductibles are a "license to steal". Rather that induce carriers to act prudently to provide maximum care and protection for goods in transit, a deductible in a bill of lading contract presents an opportunity for economizing at the shipper's expense. This is of real concern in today's highly competitive transportation market plagued by tight money and carrier bankruptcies.

The ability to limit liability through minimum nad maximum claim amounts has also reduced railroad claim payments by substantial amounts. These limits are offered to shippers at the standard rate level as an alternative to liability for "full actual loss".

5. Short time limits

Short time limits also catch many unsophisticated shippers by surprise. Time limits ranging from 3 to 6 months for filing claims are common in railroad tariff rules. Suit-filing time limits have also been shortened to catch the unwary shipper and thus evade payment of lawful claims. Some railroads require the filing of a suit within 90 days of a declination; others allow one year from declination, while others fix the one year limit from the date of delivery.

When compared to the traditional time limit of nine months from delivery for filing claims, and two years and a day from declination for filing suits, it is understandable why these short time limits catch the unwary, and thus permit railroads to evade liability.

6. Venue

Another problem caused by The Staggers Act of 1980 stems from the venue changes enacted in 49 U.S.C. § 11707(d)(2)(a). This new provision wrongfully restricts plaintiffs in loss and demage actions against suing an origin carrier in any jurisdiction in which that carrier is doing business, except at origin. Thus, a general creditor against a railroad may sue the carrier in any jurisdiction in which that carrier is doing business, but a claimant under § 11707 may only sue that carrier at the point of origin.

This is an unreasonable, unconstitutional limitation on a plaintiff's rights, and must be repealed. Railroads have adequate protection under state substantive laws to remove actions to more convenient locations if the venue chosen by the plaintiff is improper.

The I.C.C. recommended repeal of this Staggers Act provision in Ex Parte 403, *Report to Congress*, page 37. The Council urged that the venue provisions of § 11707 be restored to their pre-1980 status.

7. Jurisdictional limits On Federal courts

Effective October 20, 1978, Congress imposed a $10,000 limitation on the jurisdiction of the federal district courts over loss and damage claims suits. P. Law 95-486, 92 Stat. 1633. The reason for this revolutionary change was the alleged overburdening of the federal courts in Boston with suits on fresh produce moved by rail due to a localized problem.

As a result, claimants and carriers throughout the nation are deprived of uniform federal court decisions on all interstate commerce freight claim litigation under $10,000.

The I.C.C. recommended that this change in the law be repealed. Ex Parte 403, *Rail Cargo Liability Study*, October 19, 1981, pages 40 and 53.

The Council urges that the Committee adopt the I.C.C.'s recommendation to amend 28 U.S.C. § 1337 accordingly.

D. 49 U.S.C. § 10505 (e) —THE CULPRIT

Section 10505(e) was enacted as a part of The Staggers Rail Act of 1980 in acknowledgement of the need to retain full Carmack liability for shippers desiring such protection. This section empowers the I.C.C. to exempt railroads from its regulations, but not from the liability standards embodied in 49 U.S.C. § 11707 (The Carmack Amendment).

However, Congress provided that railroads may offer "alternative terms", obviously referring to the Carmack liability terms as the fundamental liability standards with which the "alternative terms" may alternate.

Nevertheless, many railroads have interpreted this section as permitting changes in their common law liability in return for a lower rate. The complete exoneration takes place in the form of shifting the burden of proof to the claimant, thus making it virtually impossible to prove carrier negligence. Some railroads substitute a comparative negligence standard which governs tort law but is inappropriate in bailment contracts.

With respect to liability for delays in transit, some railroads have refused to acknowledge liability for damages based on "market decline". Others have limited their liability to their published schedules plus 24 hours, or 48 hours. Thus, these carriers have contracted against being liable for the first 24 or 48 hours of their negligent acts or omissions.

A more complete list of the 14 unlawful rules found in rail carrier exempt circulars is annexed as Appendix D. These liability terms are improperly offered as "alternative terms" under the provisions of 49 U.S.C. § 10505(e). Also included in Appendix D is a review of the liability issues found in the Carmack Amendment, for which the railroads may offer alternative terms.

As stated earlier, these rules are not alternatives to the Carmack Amendment, 49 U.S.C. § 11707. They attempt to modify the public policy of this nation which 1) prohibits bailees for contracting against their negligent acts; 2) makes common carriers liable for the difference between the wholesale destination market value of goods in good condition on the date of scheduled delivery and the market value of such goods in the condition in which they are delivered, on the date they are actually delivered; and 3) requires carriers to publish a choice of released rates and full value rates if they desire to limit the amount of their liability, on condition that such rates be fair, open, just, reasonable and proportioned to the risks.

The public policy also mandates that when a shipper agrees to limit a carrier's liability, it must expressly declare the value of the shipment and affirmatively elect to ship under the released value tariff. This would preclude "automatic releases" which spring into play on the basis or the carrier's hidden tariff rule without the necessity of the shipper's affirmative selection of a rate or liability coverage.

E. DISCRIMINATORY LIABILITY TEAMS

Another example of a railroad's unlawful policy on liability is illustrated by a recent rate quotation by the Southern Pacific Railroad. The S.P. refused to quote rates on frest grapes to a California shipper until the shipper furnished a list of its consignees. It then quoted rates for shipments to each of those consignees which varied from 110% to 180% above the base rate. The differential was based upon the number of claims historically filed by each consignee.

Obviously, such a differential is contrary to the Carmack Amendment and the common law governing common carriers. However, the shippers and consignees find little comfort in expensive, protracted litigation to establish the impropriety of this policy, with no immedaite relief for the present marketing season.

F. TOFC/COFC TRAFFIC

The Commission's exemption of TOFC/COFC rail traffic has resulted in a proliferation of claim declinations and shippers' unrecoverable losses. Shortly after the exemption was announced, the Council unsuccessfully attempted to have the Commission review the exculpatory clauses in the newly exempt TOFC/COFC circulars. The Commission refused to intervene, concluding that:

"To the extent railroad tariffs or contractual items on TOFC/COFC service are in violation of 49 U.S.C. 11707, they are unenforceable as a matter of law. However, to the extent tariff or contractual terms are otherwise construed as offers limiting liability open to negotiation, they may be pursued. In this regard, we note that 49 U.S.C. 11505(e) permits carriers to offer alternative terms, such as limited liability provisions. Moreover, 49 U.S.C. 11707 permits a carrier to limit its liability under 49 U.S.C. 10730, which allows carrier and shipper negotiation of limited liability provisions. Thus, reduced liability on the part of the carrier may be entirely acceptable to shippers in the context of rates. Petitioner neither identified any individual shipper who is objecting nor complained in the context of specific rates. To this extent, petitioner has presented, in effect, only examples of carrier offers limiting liability, which the carriers may pursue as discussed above.

"If concrete problems arise with respect to carrier loss and damage practices, we would, of course, accept petitions to amend in an appropriate manner the exemption given TOFC/COFC traffic. Because 49 U.S.C. 10505(d) explicitly also grants us the authority to revoke an exemption in whole or in part, we can and will protect the legitimate interests of shippers, carriers, and the public in general. We plan to monitor closely the carriers' use of the exemption." Ex Parte No. 230 (Sub-N[illegible] 5), June 22, 1981, F.R. 32257.

Obviously, the I.C.C. has not monitored the railroads' use of the exemption to evade liability for loss, damage or delay during the past four years and apparently has no intention of doing so.

The problem with the railroads' claim policy on TOFC/COFC traffic is that they have placed an impossible burden of proof on claimants. Railroads collectively refuse to acknowledge liability on ramp-to-ramp plans unless there is physical damage to the exterior of the trailer or container. They arbitrarily contend that any damage discovered at final destination could have occurred during the cartage movements to or from the railroad ramps.

Aside from the antitrust questions raised by this industry policy, this position ignores the substantial differences in the railroad and highway environment which cause damage, i.e., the number of switchings, length of haul, pitch and sway, higher center of gravity on a flat bed, the movement of piggyback cars forward and backwards, etc. Furthermore, claimants have an impossible burden of proving where the damage took place because of railroads' policy against opening trailers or containers at ramps to permit verification of the condition of the loads.

As a result, claims payments on TOFC/COFC traffic are limited to claims involving derailments and thefts. In some instances, shippers have reported discontinuing the use of TOFC/COFC solely due to the unrecoverable losses experienced with such services.

Shipper's agents and piggyback consolidators have resorted to offering insurance coverage to their shippers due to the difficulties experienced in collecting claims on TOFC traffic. Therefore, the shipping public is bearing an extra cost which should be absorbed by the railroad responsible for the loss or damage.

For a list of specific claim problems stemming from the I.C.C.'s exemption of TOFC/COFC traffic, see Appendix E.

G. ARBITRATION OF PROPERTY CLAIMS

Congress enacted the first arbitration statute for transportation claims when it enacted Sec. 11711 of Title 49 in the Household Goods Act of 1980, P.L. 96–454, October 15, 1980. The need for a dispute settlement program for property claims is as great today as it was for household goods claims in 1980. The reason is that carriers have an advantage over claimants, in that it is too costly to litigate in the event a carrier refuses to voluntarily pay a lawful claim. In many cases, the expense of litigation would exceed the amount of the claim.

Accordingly, small property claims should be eligible for the same alternative dispute settlement programs as Congress provided for household goods shippers. Although it may appear at first blush that property shippers are more sophisticated than household goods shippers, the Council's experiences during the past eleven years indicates that there are vastly more shippers unsophisticated in claims and carrier liability issues than those who are knowledgeable in these subjects.

Existing arbitration systems are not completely satisfactory because they are voluntary. The I.C.C. recommended enactment of arbitration legislation in its Report to Congress in Ex Parte 403, page 55.

The Committee is urged to adopt legislation which would extend the provisions of Sec. 11711 to property claims of $5,000 or less against all common carriers, as set forth in Appendix F, creating a new Sec. 11712. An additional benefit of this proposal is that carriers would be induced to pay lawful claims or submit to arbitration, rather than being subject to the payment of claimant's attorney fees if the claimant prevailed in court.

H. CLAIM-FILING RESTRICTIONS

Some railroads have imposed unreasonable, unlawful restrictions on claimants' claim filing procedures. For instance:

(a) Stipulating that claims for uncertain amounts, such as "$100 more or less" shall not be deemed a claim.

This condition is in violation of the I.C.C.'s claim regulations [1] and established case law [2], which permit such filings when the exact amount of the loss can not readily be determined at the time of filing. Such claims are frequently filed quickly by claimants to avoid having the claim-filing time limit expire unintentionally, and thus extinguish the right of recovery.

(b) Stipulating that a claim must be accompanied by all supporting documents at the time of filing or it will not be deemed to have been filed.

This condition is also in violation of the ICC's ruling in Ex Parte 263 [3], and case law [4].

(c) On consolidated carloads and trailerloads, requiring that only one claim per car or trailer be filed.

This artificial restriction creates a difficult burden on shipper's agents, forwarders and consolidators receiving claims from individual shippers whose goods are lost or damaged. The consolidator can not wait until the day before the claim-filing time limit expires and then file a claim against the railroads for all of the individual claims received.

The more prudent practice requires claims to be filed with the railroads as soon as they are received from each owner of the goods involved. This does not create a hardship on the railroads, as each claim refers to the car number and shipping date.

Each of these new railroad rules is intended to catch the claimant by surprise and thus permit the railroads to evade payment of the claim on technical grounds.

I. TIME LIMITS FOR OVERCHARGE CLAIMS

When the I.C.C. exempted railroads hauling produce, TOFC/OCFC traffic, boxcar traffic, frozen foods and other foods from regulation, the railroad industry was freed of the statutory time limit for instituting actions at law to collect freight charges and to recover overpayments, as provided in 49 U.S.C. § 11706.

Only a few carriers have opted to shorten the time limit imposed on shippers to file overcharge claims against them. One such carrier reduced the time limit from the statutory three-year period to nine months from the date of delivery. This shortened period of time within which shippers must have their freight bills audited and reaudited, and have overcharge claims prepared and filed, will result in severe unrecoverable losses to many shippers, particularly to the smaller shippers lacking sufficient volume to warrant employment of a trained traffic staff capable of detecting overpayments.

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[1] Ex Parte 263, 340 I.C.C. 515, 554–555; and April 18, 1972 Order, Question No. 1:

"Do the provisions of sections 1005.2 (b) and (d), when taken together, preclude the payment of a claim by a carrier when a claim is filed within 9 months for '$100 more or less', even though the exact amount of the claim cannot be determined until after the 9-month period has elapsed?

"Answer. No. If a claim is filed with a carrier within 9 months, or any other period of longer duration that the carrier may establish for filing of claims, and the shipment involved is identified by the claimant seeking damages, payment is not barred by the fact that the specific amount claimed cannot be detemined within the 9-month period. The carrier must investigate the claim. It may not, however, voluntary pay the claim until such time as the amount of money due the claimant is specified or determinable."

[2] *Thompson* v. *James G. McGarrick Co., Inc.*, 205 F.2d 897 (5th Cir. 1953).

[3] Ex Parte 263, April 18, 1971 Order, Question No. 11. "May a carrier disallow a claim until the supporting documents required under the regulations are contained in the claim file?

"Answer. The answer to this question really depends upon the meaning of the word 'disallow'. A carrier may not pay a claim until such time as it is fully and properly supported. The regulation should not be construed, however, to mean that a given claim should be declined or returned when it is filed simply because certain of the required supporting documents have not been supplied or are not in the file."

[4] *Bond Stores, Inc.* v. *Overland Package Freight Service, Inc.*, 13 N.Y.S. 2d 928, 932 (Mun. Ct. 1939).

In view of the fact that there is no legislative history reflecting a Congressional intent to produce such a result, and in view of the long-existing three-year time period for filing overcharge claims, 49 U.S.C. § 10505 should be amended to preclude the I.C.C.'s exemption of railroads from the time-tested time limits embodied in § 11706.

J. SUMMARY OF REQUESTED LEGISLATIVE RELIEF

The shipping public must be relieved of the monumental transit losses totalling $160 million a year made possible by statutory changes in railroad liability. The following statutory amendments are urged:

1. Repeal that portion of subsection (c) of § 10730 which permits deductibles in agreements between shippers and carriers limiting the carrier's liability to an agreed value.

2. Add to § 10730(c) of 49 U.S.C. a new Section providing that:

"Common carriers and freight forwarders may, by a fair, open, just and reasonable agreement limit the amount recoverable by a shipper in case of loss or damage, to an agreed value made for the purpose of obtaining the lower of two or more rates or charges proportioned to the amount of the risks in transit. Such limitations may not provide for specific amounts to be deducted from any claim or for automatic releases."

3. Require railroads to offer their "full actual loss" rates as their normal rates, with provision for offering a reasonable lower rate for limited liability as an alternative.

4. Repeal the second sentence of 49 U.S.C. § 10505(e) providing for "alternative terms"; or at least clarify the intent that railroads may only offer alternatives to the provisions of 49 U.S.C. § 11707, and not to the common law.

5. Add Section 11712 to 49 U.S.C. to provide for arbitration of claims on property shipments seeking recovery of less than $5,000.

6. Repeal the jurisdictional limit of $10,000 on property claims brought under 49 U.S.C. § 11707 in the federal courts, 28 U.S.C. § 1337.

7. Codify the I.C.C.'s claim regulations in 49 C.F.R. 1005 and the I.C.C.'s April 18, 1972 Order in Ex Parte 263.

8. Restrict the I.C.C.'s power to exempt railroads from the provisions of 49 U.S.C. § 11706, establishing uniform time limits for the collection of undercharges and overcharges in freight charges.

9. The venue provisions in 49 U.S.C. § 11707(d)(2)(a) must be restored to permit suits against railroads in any state in which they are doing business.

Statement of James R. Snyder, Chairman, Legislative Committee, Railway Labor Executives' Association

The Interstate Commerce Commission over the past five years has established a policy toward employee rights and interests contradictory of that established by the Congress under the Staggers Act and earlier legislation and totally irreconcilable with the policy of the ICC as clearly enunciated in its decisions prior to 1980. The Commission, zealously promoting the concept of deregulation of the railroad industry, has now included among those regulations which should be eliminated as burdensome to rail management, the employee protection formulae routinely imposed in the Commission's discretion in earlier days, the collective bargaining agreements negotiated pursuant to the provisions of the Railway Labor Act, and indeed, the very provisions of the Railway Labor Act itself.

Because of the incredibly extreme position taken by the Commission against the interests of railroad employees, the Sante Fe and Southern Pacific witnesses in their merger case now pending before the ICC have blithely requested the Commission to relieve those railroads of the obligations of their collective bargaining agreements when the Commission approves that merger. It is the considered judgement of those who follow Commission activity that the Commission will accommodate that request.

The Commission, in doggedly pursuing its pro-laizez-faire management course, has exceeded its authority under the law; has misread the intent of the Congress in enacting the Staggers Act; has ignored its own precedents which disclaim jurisdiction to interfere in labor matters; has ignored court rulings of the past as well as current rulings which reverse ICC misinterpretation of its authority; and, has conciously determined to place itself in an overt adversarial position to the interests of the railroad employees.

In order to appreciate the gravity and effects of the errors which the ICC has committed and will continue to commit in the name of deregulation, one must look to the history of rail labor relations—and particularly the subject of employee protection—before the Congress, the courts and the Commission. It is clear that only by explicit, specific amendment to the law in the area of labor relations will the ICC be deterred or diverted from its dedicated objective of relieving rail managment, not only from the "burdens" of employee protection provisions, but also from the "burdens" of the Railway Labor Act as well. The legislative history of the Staggers Act, indeed its plain language, demonstrates such arrogation of authority by the Commission to be unwarranted and dangerous to the continuation of peaceful labor relations in the railroad industry.

I. HISTORY OF EMPLOYEE PROTECTION IN THE RAILROAD INDUSTRY PRIOR TO THE ENACTMENT OF THE STAGGERS RAIL ACT

The first example of direct and specific provision for the protection of railroad employees is found in the Emergency Railroad Transportation Act of 1933, Act of June 16, 1933, Ch. 91, Sections 1-17 and 209, 48 Stat. 211.[1] This law was enacted in a time of great financial peril for the railroad industry. It was passed to save certain railroads from bankruptcy and to perpetuate an efficient means of railroad transportation in the United States. *Louisville and N.R. Co.* v. *United States*, 10 F. Supp. 185, 191 (N.D. Ill., 1934). In the words of the district court in the *Louisville and N.R. Co.* case, the 1933 Act evidenced "the announced policy of the Government to render assistance to all carriers and keep their heads above water until calmer times appeared". 10 F. Supp. at 192.

Certain provisions of the 1933 Act amended the merger provisions of the Transportation Act of 1920, 41 Stat. 480. Other provisions of the 1933 Act provided for the appointment of a federal coordinator of railroad transportation who was charged with the duty of encouraging, promoting or requiring action on the part of railroads, which would avoid unnecessary duplication of services and facilities, and promote financial reorganiation. There was also provision for the immediate study of other means of improving conditions surrounding railroad transportation. [1933 Act, Section 4, 48 Stat. 212.] All action taken to carry out the purpose of the 1933 Act was governed by Section 7(b) which provided as follows:

"The number of employees in the service of a carrier shall not be reduced by reason of any action taken pursuant to the authority of this title below the number as shown by the pay rolls of employees in service during the month of May, 1933, after deducting the number who have been removed from the pay rolls after the effective date of this Act by reason of death, normal retirements, or resignations, but not more in any one year than 5 percentum of said number in service during May, 1933; nor shall any employee be deprived of employment such as he had during said month of May or be in a worse position with respect to his compensation for such employment, by reason of any action taken pursuant to the authority conferred by this title."[2]

Section 7(b) of the 1933 Act clearly provided that in mergers or other matters to which it applied, an employee must be given a job at least equivalent to his former position and compensation equal to that which he formerly received; in other words, he must be placed in no "worse position with respect to his employment".

Section 17 of the 1933 Act provided that the provisions relating to the federal coordinator should expire on June 16, 1934, unless extended by proclamation of the President. The Act was extended to June 17, 1936, on which date it expired.

One month before the 1933 Act was to expire, an agreement was executed in Washington, D.C., by 85% of the major railroads in the United States and all of the standard railroad labor unions. This agreement was entitled "Agreement of May,

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[1] Congress has evidenced a concern for railroad employees for almost a century, and it has attempted to shield railroad employees from arbitary and unilateral acts of employers since the Arbitration Act of 1888. See, C.M. Rehmus, *Railway Labor Act at Fifty*, pp. 1-22 (GPO 1977) (Published under auspices of National Mediation Board).

[2] 48 Stat. 213. Paragraph (d) of Section 7 directed the Federal Coordinator of Railroads to require the railroads to compensate employees for financial losses caused by reason of moving to follow their work when it had been transferred:

"The Coordinator is authorized and directed to provide means for determining the amount of, and to require the carriers to make just compensation for, property losses and expenses imposed upon employees by reason of transfers of work from one locality to another in carrying out the purposes of this title."

1936, Washington, D.C." and is commonly referred to in the railroad industry as the "Washington Job Protection Agreement" (a misnomer as it does not protect jobs) or the "Washington Agreement".[3] The purpose of the agreement was to provide partial financial protection to employees who were deprived of their employment or otherwise adversely affected in their employment as a result of a "coordination"[4] and to provide through specific provision and negotiation a means of protecting an affected employee in his seniority rights, place of work, and type of work.

The expiration of the 1933 Act did not affect the merger provisions of the Transportation Act of 1920. Section 5(4) of the Interstate Commerce Act permitted approval of a merger upon findings by the Commission that such merger would "be in harmony with and in furtherance of the plan for the consolidation of railway properties established pursuant to paragraph (3) and will promote the public interest".[5] The Commission had the power to approve a merger "upon the terms and conditions and with the modifications so found to be just and reasonable".[6]

In 1939, the Supreme Court unanimously reversed a district court decision and affirmed the Commission's power to impose employee protective conditions as "just and reasonable conditions" in the public interest. *United States* v. *Lowden*, 308 U.S. 225, 60 S.Ct. 248, 84 L.Ed. 208 (1939). In its decision, the Court said (308 U.S. at 233, 234):

> "It is thus apparent that the steps involved in carrying out the congressional policy of railroad consolidation in such manner as to secure the desired economy and efficiency will unavoidably subject railroad labor relations to serious stress and its harsh consequences may so seriously affect employee morale as to require their mitigation both in the interest of the successful prosecution of the congressional policy of consolidation and of the efficient operation of the industry itself, both of which are of public concern within the meaning of the statute."
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> "One must disregard the entire history of railroad labor relations in the United States to be able to say that the just and reasonable treatment of railroad employees in mitigation of the hardship imposed on them in carrying out the national policy of railway consolidation has no bearing on the successful prosecution of that policy and no relationship to the maintenance of an adequate and efficient transportation system."

The Transportation Act of 1940, 54 Stat. 899, effected a considerable liberalization of the merger requirements of the Interstate Commerce Act. No longer would railroads seeking authority to merge be required to prove that their merger would be "in harmony with and in furtherance of" a national plan for railroad consolidation established by the Commission or that it would "promote" the public interest. The railroads now need only to prove that their merger would in "consistent" with the public interest.[7]

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[3] Prior to the negotiation of the WJPA, the ICC had concluded in *St. Paul Bridge & T. Ry.—Control*, 199 I.C.C. 588, (1934), that it had the authority to impose, as a condition of its approval of a consolidation application, "just and reasonable requirements . . . in the interests of employees of the railways concerned." 199 I.C.C. at 596. The conditions imposed in the *St. Paul Bridge* case, however were general (199 I.C.C. at 597), but after the Washington Agreement was negotiated, the Commission used that agreement as a model for its pre-Transportation Act of 1940 protections. See, *United States v. Lowden*, 308 U.S. 225 (1939).

[4] A "coordination" is defined in Section 2(a) of the Agreement as "joint action by two or more carriers whereby they unify, consolidate, merge, or pool in whole or in part their separate railroad facilities or any of the operations or services previously performed by them through such facilities".

[5] Act of February 28, 1920, Ch. 91, 41 Stat. 480, 482; Act of June 16, 1933, Ch. 91, Title II, 48 Stat. 217-220.

[6] Ibid. It is to be noted that Section 5(2) [now § 11343 following recodification on October 17, 1978] permits the Commission to approve mergers if it finds them to be "*consistent* with the public interest" whereas the merger provisions of the 1920 Act as amended by the 1933 Act required the Commission to find that such mergers would *promote* the public interest and not merely be consistent with that interest. In addition, the Commission had to find that the merger would be in furtherance of the plan for the consolidation of railway properties which had been established by the Commission in accordance with Section 5(3) of the Interstate Commerce Act as it has been amended by the 1933 Act. Section 5(3) provided for the adoption by the Commission of a plan for the consolidation of the railway properties "of the continental United States into a limited number of systems".

[7] See *County of Marin* v. *United States*, 356 U.S. 412, 78 S. Ct. 880, 2 L.Ed. 2d 879 (1958) in which the Supreme Court said (356 U.S. at 416-417): "The congressional purpose in the sweeping revision of § 5 of the Interstate Commerce Act in 1940, enacting § 5(2)(a) in its present form, was to facilitate merger and consolidation in the national transportation system."

Congress was thoroughly familiar with the serious and extensive adverse effects which the utilization of Section 5(2) would have on railroad employees. Therefore, in enacting those provisions, Congress added a subparagraph (f) which required mandatory protection for railroad employees similar to that which it had provided for such employees in the 1933 Act. Specifically, Congress provided that employees could not be placed "in a worse position with respect to their employment" as a result of the utilization of the liberalized merger provisions for a period of at least four years after the merger.

In 1940, a case arose under the abandonment provisions of the Act (49 U.S.C.A., Sec. 1(18)) in which the Commission held that it had no power to impose protective conditions. *Pacific Electric Ry. Co. Abandonment*, 242 I.C.C. 9 (1940). Section 1(18) provided:

". . . 'no carrier by railroad subject to this part shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment'."

Section 1(20) empowered the Commission to "attach to the issuance of the certificate such terms and conditions as in its judgment the public convenience and necessity may require". (49 U.S.C.A., Sec. 1(20).)

The Commission in its opinion in that case pointed out that it had held in a case which arose prior to the Supreme Court's decision in the *Lowden* case that it had no authority to impose employee protective conditions in abandonment proceedings. *Chicago G.W.R. Co. Trackage*, 207 I.C.C. 315. It was argued by the Railway Labor Executives' Association that because of the *Lowden* decision the Commission should reconsider its former position on the issue. The Commission, however, held that the term "public convenience and necessity" as found in Section 1(18)-(20) was less broad than the term "public interest" and, therefore, the Commission could not impose conditions for the protection of employees because they were not included within the concept of "public convenience and necessity".

The Commission decision was appealed to the then District Court of the United States for the District of Columbia which reversed the Commission's conclusion that it lacked power under Section 1(18)-(20) to impose conditions for the protection of employees. *Railway Labor Executives' Association, et al.* v. *United States, et al.*, 38 F.Supp. 818 (D.D.C., 1941).

The Interstate Commerce Commission and the Pacific Electric appealed the District Court's decision to the Supreme Court which unanimously affirmed the lower court. *Interstate Commerce Commission* v. *Railway Labor Executives' Association*, 315 U.S. 373 (1942). In its decision, the Supreme Court accepted the Pacific Electric's figures that of $378,000 in proposed savings $302,000 represented employee wages.

In the course of its opinion the Court said (315 U.S. at 376-380):

"The phrase 'public convenience and necessity' no less than the phrase 'public interest' must be given a scope consistent with the broad purpose of the Transportation Act of 1920: to provide the public with an efficient and nationally integrated railroad system. * * * And if national interests are to be considered in connection with an abandonment, there is nothing in the Act to indicate that the national interest in purely financial stability is to be determinative while the national interest in the stability of the labor supply available to the railroads is to be disregarded. On the contrary, the Lowden case recognizes that the unstabilizing effects of displacing labor without protection might be prejudicial to the orderly and efficient operation of the national railroad system. Such possible unstabilizing effects on the national railroad system are no smaller in the case of an abandonment like the one before us than in a consolidation like that involved in the Lowden case. Hence, it is only by excluding considerations of national policy with respect to the transportation system from the scope of 'public convenience and necessity', an exclusion inconsistent with the Act as this Court has interpreted it, that the distinction made by the Commission can be maintained.

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". . . the construction placed upon § (18)-(20) by the Commission is not only hostile to the major objective of the Act and inconsistent with decisions of this Court, but irreconcilable with its own interpretations of § 5(4). Under such circumstances, we believe the court below was amply justified in refusing to accept the Commission's construction."

For a decade following the passage of the Transportation Act of 1940, the Commission slowly began to evolve what it deemed to be fair and equitable arrangements to protect railroad employees in the event of a consolidation or merger. At first the Commission reserved jurisdiction to consider what protections, if any, should be imposed if it subsequently learned that railroad employees had in fact been adversely affected. *Minneapolis & St. L.R.R.—Reorganization*, 244 I.C.C. 357 (1941). Then, in *Oklahoma Ry. Trustees—Abandonment of Operations*, 257 I.C.C. 177 (1944), a Section 5(2) purchase proceeding, the Commission imposed five detailed conditions upon its approval intended to protect railroad employees. Those conditions are commonly referred to as the *Oklahoma* conditions and provided that the protective period during which the protections were to be given "shall extend from the date on which the employee was displaced to the expiration of 4 years from the effective date of our order herein . . . ," and less if the employee had less than 4 years of service. 257 I.C.C. at 198, § 4. In 1946 the Commission decided the *Chicago & N.W. Ry.—Merger* case, 271 I.C.C. 672 (1946), and rather than impose a specific formula for the protection of employees, simply imposed the second sentence of Section 5(2)(f) as a condition of its approval. In subsequent cases, rather than spelling out anew with appropriate name changes the specific provisions imposed to protect railroad employees, the ICC incorporated protective provisions into its orders by merely referring to the case in which the intended conditions were initially imposed.

In 1950, a question arose as to whether the 4-year period referred to in the second sentence of Section 5(2)(f) [now § 11347] should be regarded as a maximum limitation upon the power of the Commission to impose conditions or a minimum limitation upon that power. This question arose as a result of the Commission's approval of an application under Section 5(2)(f) to consolidate the various rail passenger terminal facilities at New Orleans, Louisiana, by the construction of a terminal to be called the New Orleans Union Passenger Terminal. The Commission regarded the 4-year period as a maximum limitation upon its power and it, therefore, limited the period of employee protection granted in that case to 4 years from the date of its order approving construction of the terminal. That limitation would have meant the complete loss of protection to employee affected by the construction of the terminal since the construction could not be completed within 4 years from the date of the Commission order and the employees would not be affected until the terminal had been completed. *New Orleans Union Passenger Terminal Case*, 267 I.C.C. 763 (1948).

The matter was pursued before the United States District Court for the District of Columbia which upheld the Commission and was then appealed to the Supreme Court, which reversed the District Court and the Commission. *Railway Labor Executives' Association* v. *United States*, 339 U.S. 142, 70 S.Ct. 530, 94 L.Ed. 721 (1950). The Supreme Court reviewed the legislative history of Section 5(2)(f) and concluded as follows (339 U.S. at 155):

"We conclude, therefore, that the Commission, while required to observe the provisions of the second sentence of § 5(2)(f) as a minimum protection for employees adversely affected, is not confined to the 4-year protective period as a statutory maximum. The Commission has the power to require a fair and equitable arrangement to protect the interests of railroad employees beyond four years from the effective date of the order approving the consolidation."

Upon remand to the Commission, that agency stated:

"From the beginning, we have patterned the conditions which we prescribed after the Washington Agreement. Since the enactment of section 5(2)(f), the conditions prescribed by us differed from that agreement as to when the protection afforded was to begin, the duration thereof, and the amount of the annual allowance to be made because all such matters were regarded as being fixed by the statute. *New Orleans Union Passenger Terminal Case*, 282 I.C.C. 271 at 280–81 (1952).

However, having been informed by the Supreme Court that such a limited view was inconsistent with the statute, the Commission imposed as an employee protective arrangement, the Washington Agreement, modified as to earnings from outside employment, and also required that employees affected within four years from the effective date of the original order were to receive the *Oklahoma* protections. Id. at 281–82. The conditions imposed in the *New Orleans* case, commonly called the *New Orleans* conditions, incorporated by reference both the Washington Agreement and the *Oklahoma* conditions,[8] and became the basic arrangement imposed by the ICC in control and merger cases.

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[8] In a decision on remand in *Southern Ry.—Control—Central of Ga. Ry.*, supra, 331 I.C.C. at 162, the Commission described the *New Orleans* conditions as follows:

"We consider the net effect of our decision in the *New Orleans* case was to formulate and impose a separate code of employee protective conditions as a minimum fair and equitable standard, which superimposes the *Oklahoma* conditions upon the provisions of the Washington Agreement."

The *New Orleans* conditions have been imposed by the Commission in consolidation,[9] trackage rights,[10] merger,[11] reorganization,[12] and lease [13] cases.

The Commission, however, did not impose the *New Orleans* conditions in all proceedings arising under former Section 5(2). As Exhibit A,* which is attached hereto, shows,[14] the ICC continued after 1952 to impose the *Oklahoma* conditions in some Section 5(2) cases, and it used a protective formula known as the *Burlington* conditions [15] in most abandonment cases under former Section 1(18) of the Act (now, 49 U.S.C. § 10903). While it appears the Commission may have drawn an arbitrary distinction between the types of transactions regulated by former Section 5(2)(a) of the Act in determining whether to apply the *New Orleans* or *Oklahoma* conditions [see, *Norfolk & W. Ry.—Trackage Rights—BN*, 354 I.C.C. 605, 607 (1978), reopened February 23, 1979], the Commission has explained its selection process as follows:

"While there have been certain section 5 proceedings decided after the *New Orleans* case in which we have imposed the *Oklahoma* conditions for the protection of employees, they have been cases in which (1) there was no showing of adverse effect, or (2) measures already taken for the protection of employees had been developed to the point where the *Oklahoma* conditions alone thereafter would satisfy the statutory requirements." *Southern Ry.—Control—Central of Ga. Ry.*, supra, 331 I.C.C. at 163.

In 1962 a case arose which ultimately required the Commission to delineate with great care and deliberation the Commission's view of its authority under the Interstate Commerce Act vis a vis employee rights under that Act, the Railway Labor Act and collective bargaining agreements.

Dissatisfied with imposing the *New Orleans* protective arrangement by reference, the Commission decided in 1962 to codify that standard protective formula. On November 7, 1962, the Commission issued its decision in *Southern Ry.—Control—Central of Ga. Ry.*, 317 I.C.C. 557 (1962), in which it stated that it was imposing the *New Orleans* conditions, with a modified arbitration procedure, as an employee protective arrangement. However, instead of incorporating those conditions by reference, the ICC attached an appendix to its order which detailed the protective provisions it intended as a codification of the *New Orleans* conditions. Unforunately, the appended detailed conditions did not contain some of the essential protections of the *New Orleans* conditions. RLEA challenged those conditions by judicial review, and in December 1964, the Supreme Court remanded the case back to the Commission for clarification of its order.[15] *Railway Labor Executives' Assoc.* v. *United States*, 379 U.S. 199 (1964). Upon remand, the Commission held a hearing at the request of the railroads but after hearing from 206 employee witnesses, a shocked Commission, finding "a callous disregard by [railroads] for the established rights and interests of the employees",[16] unanimously set forth in extensive detail the Commission's very limited role in labor relations and the limited authority granted it by the Congress. The Commission report stated that when it had imposed the *Southern—Central of Georgia* conditions, it had fully intended to impose the *New Orleans* conditions with one modification—a compulsory arbirtaion procedure:

"Beyond doubt, the Washington Agreement was the foundation upon which all employee protective plans have been constructed. It was the basis for the legislation from which evolved section 5(2)(f). And, in framing the conditions to be imposed in this proceeding, we relied upon our holding in the *New Orleans* case that imposition of the provisions of the Washington Agreement, subject to limitations discussed therein, would provide, the fair and equitable arrangement by the statute.

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[9] *New Orleans Union Passenger Terminal, Etc.* 282 I.C.C. 271 (1952).

[10] *Erie R. Co. Trackage Rights*, 295 I.C.C. 303 (1956).

[11] *Louisville & N.R. Co. Merger*, 295 I.C.C. 457 (1957).

[12] *Florida East Coast Ry. Reorg.*, 307 I.C.C. 5 (1958).

[13] *St. Louis S.W. Ry. Co. of Texas Lease*, 290 I.C.C. 205 (1953).

* The exhibit have been retained in the Committee files.

[14] Exhibit A is a list of all reported decisions from the *New Orleans* decision to and including Volume 347 in which protections were imposed.

[15] The *Burlington* conditions were first imposed in the *Chicago, B. & Q. R.R.—Abandonment*, 257 I.C.C. 700 (1944), and derive their name from that case. A comparison of the *Burlington* and the *Oklahoma* conditions shows that the only substantive difference between the two is that in the *Oklahoma* conditions, the Commission provided that the affected *Oklahoma* employees did not have to relocate to retain their protections.

[15] RLEA had challenged the failure of the ICC to include Sections 4 and 5 [notice and negotiation of implementing agreements] and 9 [lump sum separation pay] of the Washington Agreement in its codified provisions, and the Supreme Court's remand referred to those provisions only.

[16] 331 I.C.C. at 185.

". . . Except for this minor change in the arbitration procedure [mandatory and binding], we made no change in the original *New Orleans* conditions." *Southern Ry.—Control—Central of Ga. Ry.*, supra, 331 I.C.C. at 164.

The Commission then spells out its views of the law that it had no authority to supersede collective bargaining agreements; that protective conditions were placed *upon carriers* for the *protection* of employees; that employee rights under collective bargaining agreements, protective agreements (such as the Washington Agreement) and conditions imposed by the Commission were "separate, independent and distinct rights"; that the Commission-imposed conditions were "designed to apply after the carriers had arrived at their adjustments of labor forces *in accordance* with the governing provisions of their collective bargaining agreements; and, that the transportation and labor laws of the nation must be accommodated to each other. These views remained constant until the period following enactment of the Staggers Act [331 I.C.C. at 168–170]:

"Next, we focus on applicant's contention that when the Commission prescribed a specific code of employee conditions pursuant to section 5(2)(f), section 5(11) [now § 11341] of the act automatically relieves them from the operation of all restraints, limitations, and prohibitions insofar as may be necessary to enable them to carry into effect the transaction approved by us, in accordance with the terms imposed. They conclude that section thereby obliterates all requirements of the Washington Agreement and the collective bargaining agreements. We cannot agree.

"At the outset, we would point out that rather than being rescinded, the terms of the Washington Agreement were in substance and almost in their entirety among the conditions imposed. Moreover, there are at least two instances of record where applicants' actions are plainly inconsistent with their position on this point. First, while claiming such relief, they acknowledged at the further hearing that, in carrying out the consolidations approved, they violated the 5-day notice rules contained in the Central of Georgia collective bargaining agreements and in fact later paid the employees 5 days' pay for failure to give such notice. Second, while again claiming to be relieved of all obligations under the collective bargaining agreements, they nonetheless insist that they were compelled to follow the seniority rules contained in the Southern agreements, but were relieved from any work removal restraints contained in the Central of Georgia agreements.

"Also, we point out that, under section 5(2)(f), we impose formulae of protective conditions *upon the carriers* seeking specific permissive authority under section 5(2) of the act, the purpose being to *protect* the interests of employees some of which in a particular case may well have been established under bargaining agreements executed pursuant to the Railway Labor Act. Rights obtained by employess under section 5(2)(f) are the minimum protection which an applicant carrier must provide in order to obtain this Commission's approval of its transaction. They are not, however, the maximum rights employees may gain. See the last sentence of section 5(2)(f), and also *Overnite Transportation Co.* v. *N.L.R.B.*, decided February 2, 1967, by the United States Court of Appeals for the Fourth Circuit. The rights of railroad employees under their collective bargaining agreements, under the Washington Agreement, and under the protective conditions imposed upon the carriers under section 5(2)(f) are independent, separate, and distinct rights. We have historically recognized the independent nature of those rights and have distinguished the employee rights derived from collective bargaining agreements from those derived from conditions which we have imposed upon carriers. The rights under the former are based upon private contracts; those under the latter stem from our statutory duty to protect employees. The existence of multiple sources of employee protection does not imply, however, that any employee necessarily has a right to duplicative benefits from all sources. These protective conditions imposed upon carriers under section 5(2)(f) which provide affected employees compensatory protections for wages, fringe benefits and other losses are designed to apply after the carriers have arrived at thei adjustments of the labor forces *in accordance* with the governing provisions of their collective bargaining agreements so that the carriers may be enabled to carry on approved transaction into effect." *Texas & N.O.R. R. Co.* v. *Brotherhood of Railroad Trainmen*, (5th Cir., 1962) 307 F.2d 151. [Emphasis by the Commission.]

"Of equal importance, this contention of applicants is demonstrably erroneous. By its terms, section 5(11) applies only to antitrust and other restraints of law from carrying "into effect the transaction so approved * * *". Neither the Washington Agreement nor the specific collective bargaining agreements between these roads and their employees is such a restraint, for indeed section 5 transactions have been successfully consummated in full compliance with such terms. Cf *Chicago, St. P., M. & O. Ry. Co. Lease*, 295 I.C.C. 696. The essential problem to be resolved is an accommodation of laws, a role not foreign to us in section 5 transactions. *Seaboard Air*

Line R. Co. v. *U.S.*, 382 U.S. 154 (1965). When balancing the national policy as to transportation with that of labor relations, we "act in a most delicate area * * * [and] policies of the Interstate Commerce Act and the labor act necessarily must be accommodated, one to the other." *Burlington Truck Lines* v. *U.S.*, 371 U.S. 156 (1962).

"The designated "exclusive and plenary power" of the Commission in section 5(11) cannot be so broadly construed as to brush aside all laws—be they statutorily created antitrust laws or voluntary contractual agreements made binding by the force of law. In *McLean Trucking Co.* v. *U.S.*, 321 U.S. 67 (1943) the Court said "Congress however neither has made the antitrust laws wholly however neither has made the antitrust laws wholly inapplicable to the transportation industry nor has authorized the Commission in passing on a proposed merger to ignore their policy." And in *Minneapolis & St. Louis R. Co.* v. *U.S.*, 361 U.S. 173 (1959) we note the Court saying "* * * section 5(11) does not authorize the Commission to 'ignore' the antitrust laws * * *."

"In the railway labor arena, our jurisdiction extends to imposing conditions upon applicant. Questions arising from protective agreements entered into by the parties ordinarily are beyond our reach, and in the hands of local courts. *Texas & N.O.R. Co.* v. *Brotherhood of Railroad Trainmen*, supra."

The Commission's view of its lack of authority over labor contracts was consistent with its view regarding its authority over any contracts. As long ago as 1952, the Commission rendered a ruling precisely consistent with the recent holding of the U.S. Court of Appeals for the District of Columbia Circuit [17] which reversed one of the Commission's recent forays into the legislative field. In *G.M. & O. R. Co. Abandonment*, 282 I.C.C. at 311, the Commission ruled:

"This Commission, over a long period of years, has uniformly held that it has no power to reform contracts or to relieve carriers of their financial obligations thereunder in connection with an application under Section 1(18) [abandonments of lines, now § 10903] of the Act [49 U.S.C.A. § 1(18)].

"The Applicant fails to draw the distinction between conditions which affect only the applicant and give it the alternative of doing one thing or another, and conditions which would impair State laws or vested rights of the parties. The latter we may set aside only upon a clear grant of authority similar to that contained in Section 5(11) [49 U.S.C.A. § 5(11)] [now § 11341].

"We are of the opinion that we are not authorized by order to declare that the obligations created by the contract between the applicant and the Illinois Central are set aside other than to the extent necessary to effect a compliance with our certificate * * *."

In the years following the *New Orleans* conditions, and since the *Southern-Central of Georgia* remand decision, the Commission consistently held that the *New Orleans* conditions were the "minimum protections which the applicants must provide in order to obtain our approval of the transactions" under former Section 5(2) of the Act. E.g., *Central of Ga. Ry-Consolidation—Central of Ga. R.R.*, 338 I.C.C. 353, 377 (1971); see also, *Chicago & N.W. Ry.—Control—Chicago, R.I. & P.R.R., 347 I.C.C. 556, 650 (1974); Seaboard Air Line R.R.—Trackage Rights—Atlantic Coast Line R.*, 312 I.C.C. 797 (1962).

In 1964 the Congress faced with the collapse of privately owned urban bus, transit and rail commuter systems throughout the country, enacted the Urban Mass Transportation Act of 1964. Section 10(c) of that Act, later renumbered Section 13(c), provided not only for the protection of the economic interest of employees by guaranteeing them protections no less beneficial than those established under Section 5(2)(f) but specifically provided five additional protections, only one of which was specifically set forth in the Interstate Commerce Act [49 U.S.C. § 1609(c)]:

> (1) the preservation of rights, privileges, and benefits (including continuation of pension rights and benefits) under existing collective bargaining agreements or otherwise;
>
> (2) the continuation of collective bargaining rights;
>
> (3) the protection of individual employees against a worsening of their positions with respect to their employment;
>
> (4) assurance of employment to employees of acquired mass transportation systems and priority of re-employment of employees terminated or laid off;
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> (5) paid training or retraining programs.[18]

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[17] *Brotherhood of Locomotive Engineers* v. *I.C.C.*, 761 F.2d 714 (1985).

[18] Identical employee protective provisions were enacted into the High Speed Ground Transportation Act of 1965 [49 U.S.C. § 1636(a)].

In 1970, when confronted with the ever worsening rail passenger service crisis, the Congress created Amtrak by enactment of the Rail Passenger Service Act of 1970 (RPSA). [P.L. 91-518, 84 Stat. 1327 (1970).] Congress was aware of the adverse effects this legislation would have upon railroad employees and required each contract between Amtrak and each railroad transferring the passenger service obligations from the railroad to Amtrak to provide protections for the interests of employees. [RPSA § 405; 45 U.S.C. § 565.] The Congress lifted virtually verbatim the employee protection language found in the Urban Mass Transportation Act and placed it in Section 405 of RPSA.

Section 405(a) of that Act, 45 U.S.C. § 565(a), provided that a "railroad shall provide fair and equitable arrangements to protect the interests of employees affected by discontinuance of intercity rail passenger service . . .," and Section 405(b), 45 U.S.C. § 565(b), amplified the directive in subsection (a) by providing that such "protective arrangements shall include, without being limited to, such provisions as may be necessary" to accomplish the five objectives set forth in § 13(c) of the Urban Mass Transportation Act and listed above. Moreover, that subsection, like § 13(c), further provided:

"Such arrangements shall include provisions protecting individual employees against a worsening of their positions with respect to their employment which shall in no event provide benefits less than those established pursuant to Section 5(2)(f) of the Interstate Commerce Act."

Finally, Congress entrusted to the Secretary of Labor the responsibility to certify whether the protective arrangement affords affected employees "fair and equitable protection . . ." 45 U.S.C. § 565(b).

Rail labor and management were unable to agree upon a protective formula under Section 405, and on April 16, 1971, Secretary of Labor James D. Hodgson promulgated a protective arrangement and certified that it complied with the statutory mandate.[19] That arrangement, which was designated Appendix C-1 to the National Railroad Passenger Corporation Contract, provided those levels of protection specified in Section 405(b) (1) through (5) of the RPSA and it contained certain protections which exceeded in several respects the protections provided by the *New Orleans* conditions. First, Article 1, Sections 5 and 6 of Appendix C-1 extended the protective period of senior employees from 5 to 6 years. Second, Article 1, Section 11(e) placed the burden of proof upon the carriers after an employee "[identified] the transaction and [specified] the pertinent facts . . . relied upon". And finally, Article 1, Sections 5 and 6 provided that the monthly guarantees should be increased by general wage increases during the protective periods.

The most notable deficiency of Appendix C-1 was that, while it required carriers to give notice before they consummated a transaction (Article 1, Section 4), it permitted the carriers to consummate the transaction prior to the negotiation of an implementing agreement. Id. Also, Appendix C-1, unlike the WJPA portion of the *New Orleans* conditions, limited the protective period for a displaced employee who had less than six years of service (Art. 1, § 1(d)); unlike the *Oklahoma* portion of the *New Orleans* conditions, Appendix C-1 required an employee to relocate before he became a dismissed employee (Article 1, § 1(c)); and Appendix C-1 limited the protective period of the fringe benefits protections to six years, or the employee's length of service, if less. Compare, WJPA § 8, with, Appendix C-1, Article 1, § 8.

Several unions brought suit against Secretary Hodgson and others to enjoin Amtrak from taking over the rail passenger service on May 1, 1971, asserting that Appendix C-1 did not comply with the mandatory requirements of Section 405(b) of the RPSA. *Congress of Railway Unions* v. *Hodgson*, D.D.C. Civil Action No. 825-71. On April 30, 1971, the District Court denied the unions' request for a preliminary injunction, and in denying that motion concluded that, in the unusual circumstances of that case, particularly the statutory deadline of May 1, 1971, for Amtrak to take over passenger service, the failure of the Secretary to include the precise language of Sections 4 and 5 of the WJPA did not invalidate the provisions certified. *Congress of Railway Unions* v. *Hodgson*, 326 F. Supp. 68, 76 (D.D.C. 1971). Appendix C-1 and the equivalent protective arrangement applicable to employees of Amtrak (Appendix C-2) continue in place for the protection of employee interests affected by discontinuances of intercity rail passenger service.

In February 1976, the Railroad Revitalization and Regulatory Reform Act of 1976 ["4R Act"], Pub. L. No. 94-210, was signed into law, and by Section 402(a) of that Act, Congress amended former Section 5(2)(f) of the Interstate Commerce Act to insert near the end of that provision the following sentence: "Such arrangement shall contain provisions no less protective of the interests of employees than those heretofore imposed pursuant to this subdivision and those established pursuant to section 405 of the Rail Passenger Service Act (45 U.S.C. 565)."

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[19] See, *Review and Refunding of RPSA: Hearings on House Committee on Interstate and Foreign Commerce*, 92nd Cong., 1st Sess. at 331 (1971) (Statement of James D. Hodgson) [hereinafter, "Hearings on RPSA"].

The 4R Act also amended the abandonment provisions of the Interstate Commerce Act. In Section 802 of the 4R Act, Congress enacted a new abandonment procedure for rail carriers. While prior to that amendment, the decision whether to impose protective conditions rested within the sound discretion of the Commission (e.g., *ICC* v. *Railway Labor Executives' Assoc.*, 315 U.S. 373 (1942)), the new abandonment provisions made the imposition of employee protective provisions mandatory. 49 U.S.C. § 10903(b)(2). Moreover, that amendment also specified the minimum levels of protection which must be imposed in future abandonment cases: "Such provisions shall be at least as beneficial to such interests as provisions established pursuant to section 5(2)(f) of this Act and pursuant to section 405 of the Rail Passenger Service Act (45 U.S.C. 565)."

These two amendments incorporated into the Interstate Commerce Act for the first time the five specific requirements for the protection of bargaining agreement, representation, retraining and employment rights previously enacted into the Urban Mass Transportation and Amtrak statutes. They required the Commission to combine the protections contained in *New Orleans* with those provided in Appendix C-1.

The task of combining the two formulae of protection so as to comply with the mandate of Congress was not a simple one.

After three years and many Commission proceedings there was developed the *Oregon Short Line III* conditions for use in abandonment cases and the virtually identical *New York Dock II* conditions for use in merger, control and consolidation cases.[20] These conditions contained the vital sections 4 and 5 of the Washington Agreement (*New Orleans*) requiring notice and the execution of implementing agreements prior to a carrier's effectuating a "transaction" in furtherance of its Commission-granted authority; most of the improvement in protection developed by the Secretary of Labor in Appendix C-1; and, a specific prohibition against interference with an employee's Railway Labor Act rights:

"2. The rates of pay, rules, working conditions and all collective bargaining and other rights, privileges and benefits (including continuation of pension rights and benefits) of the railroad's employees under applicable laws and/or existing collective bargaining agreements or otherwise shall be preserved unless changed by future collective bargaining agreements or applicable statutes." (360 I.C.C. at 84 and 99.)

These new formulae of employee protection had little chance to be employed before Congress enacted the Staggers Rail Act of 1980 on October 14, 1980.[21]

II. THE COMMISSION AND THE PROTECTION OF EMPLOYEE RIGHTS AND INTERESTS SINCE THE STAGGERS ACT

A. The Staggers Act

The Congress was fully aware that its partial but significant deregulation of the railroad industry would cause severe harm to railroad employees and their families. To mitigate that result to the greatest extent feasible under the circumstances, the Congress provided for the protection of employees in every section of the Staggers Act where it seemed they would be affected. This is undoubtedly the most extensive demonstration of legislative concern for the welfare of employees ever displayed in a non-labor statute.

Section 213 [49 U.S.C. 10505] permits the I.C.C. to exempt railroads and other persons from the requirements of the provisions of the Interstate Commerce Act and Commission regulations with one notable exception:

"(g) The Commission may not exercise its authority under this section (1) to authorize intermodal ownership that is otherwise prohibited by this title, or (2) to relieve a carrier of its obligation to protect the interests of employees as required by this subtitle."

Section 219 [49 U.S.C. 10706] prohibits discussion of certain joint rates among railroads thereby possibly lessening the volume of work at rate bureaus maintained jointly by railroads. Section 219 provides:

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[20] *Oregon Short Line Railroad and the Union Pacific Railroad Company—Abandonment Portion Goshen Branch, Etc.*, 360 I.C.C. 91 (February 9, 1979); *New York Dock Railway—Control—Brooklyn Eastern District Terminal*, 360 I.C.C. 60 (February 9, 1979).

[21] P.L. 96-448, 94 Stat. 1985 (October 14, 1980).

"(g) The Interstate Commerce Commission shall require rail carrier members of a rate bureau to provide the employees of such rate bureau who are effected by the amendments made by this section with fair arrangements no less protective of the interests of such employees than those established pursuant to section 11347 of title 49, United States Code. For purposes of this subsection, the term 'employees' does not include any individual serving as president, vice-president, secretary, treasurer, comptroller, counsel, member of the board of directors, or any other person performing such functions."

Section 221 governing construction of rail lines [49 U.S.C. 10901] was inserted at the insistence of States desiring to extend lines they had bought into new market areas. The House version contained mandatory employee protection together with a provision protecting employees against anticipated effects of "entry". The Conference upon the insistence of the Senate made the protection discretionary with the ICC and removed the express provision for protection against anticipated effects. No explanation is given in the Conference Report. It was known, however, that the protection was to be used primarily to protect employees of other carriers hurt by the entry of a new carrier into its market and the state interests did not want such protection mandatory. The provision reads:

"(e) The Commission may require any rail carrier proposing both to construct and operate a new railroad line pursuant to this section to provide a fair and equitable arrangement for the protection of the interests of railroad employees who may be affected thereby no less protective of and beneficial to the interests of such employees than those established pursuant to section 11347 of this title."

The discretionary aspect of Commission authority in Section 10901 and other employee protection provisions was of little concern at the time since the only discretionary protection authority the Commission ever had (involving abandonments) was always exercised in favor of imposing protection except in very limited circumstances. In *Chicago, Attica & Southern R.—Abandonment*, 261 I.C.C. 646, 651 (1946), the Commission enunciated a policy for the exercise of its discretionary authority to impose employee protective conditions from which it did not deviate until the advent of the Staggers Act:

"Facts and circumstances in various abandonment proposals presented to us vary widely in the situations involved. These situations fall into general groups, (1) abandonment of entire properties by carriers which are no longer able to continue the struggle for survival because of highway competition or other conditions depriving them of sufficient means of livelihood; (2) partial abandonments by generally unprosperous carriers in the effort to reduce expenses and thereby perserve service to the public on their remaining lines; and (3) abandonment of main lines, branch lines, or parts of lines by carriers, not in *extremis*, where abandonment is warranted and desirable as a benefit to the transportation system, but, in the language of the court, results also in a private benefit for the railroad in the form of savings realized by discontinuing uneconomic service." [261 I.C.C. at 651.]

On balance, the Commission concluded, employee protection should not be imposed as an exercise of its discretion in groups 1 and 2, but would be imposed routinely in group 3 situations. Id. at 652.

The Commission developed exceptions to the "entire line" abandonments policy when the carrier abandoning was a subsidiary of a larger carrier, *East Carolina Ry.—Abandonment of Entire Line*, 324 I.C.C. 506 (1964); *Washington & Old Dominion R.R.—Abandonment of Entire Line*, 331 I.C.C. 587, 602 (1968); *Matter of New York, Susquehanna & Western R. Co.*, 504 F.Supp. 851 (D.N.J. 1980); when a carrier would make a profit on the abandonment, *Northampton and Bath R. Co.*, 354 I.C.C. 784 (1978); and, when a large number of employees were involved, *Penn Central Transportation Co.—Reorganization*, 347 I.C.C. 45, 92 (1973); *Central R. of N.J.—Abandonment*, 342 I.C.C. 227, 300-02 (1972).

Had RLEA suspected the Commission would abruptly and completely reverse its traditional policy regarding employee welfare (which will be discussed below), it would not have been so sanguine regarding the investment of the I.C.C. with discretionary employee protection authority in construction cases under Section 10901 or any other provision of the Staggers Act.

Section 223 [49 U.S.C. 11103] authorized the I.C.C. to require railroads to execute reciprocal switching agreements and authorized the Commission to protect employee interests:

"(2) The Commission may require reciprocal switching agreements entered into by rail carriers pursuant to this subsection to contain provisions for the protection of the interests of employees affected thereby."

Section 226 [49 U.S.C. 11123] limited the authority of the I.C.C. to issue car service orders to "nationwide" or "broad regional" emergencies but it protected employees' interests as follows:

"(3) In carrying out the provisions of this subsection, the Commission shall require, to the maximum extent practicable, the use of the employees who would normally have performed work in connection with the traffic subject to the action of the Commission.

Section 227 [11 U.S.C. 1170] requires bankruptcy courts to impose provisions for the protection of employees in the transfer or abandonment of a bankrupt railroad's lines no less protective of their interests than the protection established under Section 11347 (basically the *New York Dock* conditions).

Section 228 liberalized portions of the merger provisions of the Interstate Commerce Act [49 U.S.C. 11343] but did not affect the employee protection required by Section 11347 in merger and similar cases.

Section 401 [49 U.S.C. 10910] provides for sales of existing rail lines to "financially responsible" persons for "feeder line" development and at subsections (e) and (j) of Section 401 provides:

"(e) The Commission shall require, to the maximum extent practicable, the use of the employees who would normally have performed work in connection with a railraod line subject to a sale under this section.

* * * * * * *

"(j) In the case of any railroad line sold pursuant to this section, the Commission shall require the selling carrier to provide a fair arrangement at least as protective of the interests of employees as that established under section 11346 of this title."

Section 402 [49 U.S.C. 10903 and 10904] extensively liberalizes the abandonment provisions of the Act but leaves untouched the mandatory employee protection provisions of that section as well as the formula developed under it (*Oregon Short Line III*).

B. The Staggers Act, the Commission and employee protection

It should be evident even to one unfamiliar with the historical relationship between railroad employee protection and the Congress that in the Staggers Act the Congress did not intend to lessen traditional railroad employee protection or impair the Railway Labor Act rights of railroad employees. The Commission, however, reads the Staggers Act as a complete reversal of Congressional policy, and therefore Commission policy, regarding the treatment of employees and their rights. That Commission error can only be corrected by amendatory legislation.

Almost immediately following the enactment of the Staggers Act, the Commission began to augment Congress' deregulation scheme for the rail industry by extending it to labor relations. The Commission apparently theorized that if much of the economic regulation of the rail industry was a burden which impeded its competitive ability and should be removed, certainly employee protective conditions, collective bargaining agreement restrictions, and the fetters of the Railway Labor Act were at least as burdensome to competitive ability and warranted removal as well.

The Commission's approach to this objective has been threefold: first, it sought to circumvent the requirement that it impose employee protection in abandonments and sales of rail lines by utilizing, where possible, those provisions of the Staggers Act which made the imposition of employee protection discretionary and then to refuse to impose protective conditions—at first on grounds that the employees had not shown a need for the imposition of employee protective conditions (where only one or two or ten employees were affected) and then when such need became obvious as, for example, when a railroad sold 700 miles of its lines, it refused protection on the ground that to impose protection would be a burden on the selling (i.e. abandoning) carrier. Congress, of course, had just made mandatory the imposition of employee protective conditions in abandonment cases.

Just prior to the enactment of the Staggers Act the Commission issued a decision in a case involving its discretionary authority to impose employee protective conditions under Section 10901 of the Act.[22] That proceeding involved a Section 10901 application by Durango and Silverton Narrow Gauge Railroad Company, a newly formed carrier, to acquire and operate a line of the Denver and Rio Grande Western Railroad Company. Favorably responding to rail labor's request for protective conditions, the ICC held:

"While the Commission is not required by statute to impose labor protective conditions in proceedings where newly formed non carriers will become carriers through the acquisition and operation of lines of railroad as here, it does have the discretion to do so where the interests of employees may be adversely affected by the proposal. In *Prarie [sic] Trunk Railway—Acquisition and Operation*, 348 I.C.C. 832 (1977) and *Cadilliac [sic] & Lake City Ry. Co.—Acquisition and Operation*, 320 I.C.C. 617 (1964), the Commission imposed such conditions, with the costs to be borne by the selling carrier. In both cases, the vendors had filed abandonment applications for the rail lines in question, but those applications were dismissed. Notwithstanding the dismissal of the abandonment applications, the Commission, in each case, noted that the principal [sic] result or benefit of the proposal would be the cessation by the vendor of operation of the line. Since employees of the vendors would be affected by the proposal and since each vendee was a new carrier that had not operated previously, the Commission imposed the burden of labor protection costs upon the vendors.

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[22] *Durango & Silverton*, 363 I.CA.C. 292 (1979).

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"The instant proceeding differs somewhat from *Prarier Trunk* [sic] in that the vendor, Rio Grande, has not expressed a willingness to bear the costs of labor protection. It also differs from both *Praric [sic] Trunk* and *Cadillac* in that vendor has not filed an abandonment application for the line to cease operation thereof. The principle is the same, however, since Rio Grande is disposing of a losing operation. The burden on D&SN of institution of operations over such a line will be great enough without the additional costs of labor protection for the Rio Grande employees that are not employed in the new operation. Accordingly, the costs of labor protective conditions imposed herein shall be borne by Rio Grande." *Durango and Silverton*, 363 I.C.C. at 295.

Shortly after enactment of the Staggers Act, the ICC announced a new set of considerations in Section 10901 proceedings effectively reversing every statement so recently made in the *Durango* case. In the *Knox and Kane* case,[23] the ICC determined that while it possessed the power to impose employee protective conditions on both the acquirer and vendor, it would not exercise that authority due to a number of factors in that case. The ICC opined that employee protective provisions were neither require nor warranted in that proceeding because:

(1) The B&O did not file a concurrent abandonment application. (But neither had the Rio Grande in the *Durango* case.) The ICC stated its belief that it was obligated to follow the form of the transaction as presented to it by the carriers. "The option of how to proceed with a transaction lies with the applicants, . . . and we may not dictate otherwise." 366 I.C.C. at 433.

(2) Although the imposition of employee protection may "be consistent with certain objectives of the rail transportation policy" it "may thwart others" [366 I.C.C. 433]:

"[T]he imposition of labor conditions may tend to encourage fair wages and safe and suitable working conditions in the industry. However, our imposition of such conditions would burden B&O with a potentially large financial expense, thus frustrating *our* objective to foster sound economic conditions in transportation. . . . In addition, imposition of labor conditions might thwart the development and continuation of sound rail transportation system . . . by discouraging the sale of marginal rail facilities for operation by new carriers." (Emphasis supplied.)

The statement of the I.C.C. is irreconcilable with every earlier statement made on this subject by the Congress, the Supreme Court and the Commission. It is, of course, made without citation of authority and the reference to "our objective" would seem to indicate that the Commission may realize that its objectives and those of the Congress may be somewhat divergent.

(3) The employees' request for the assistance was filed one year after the ICC's order. The ICC believed that this time lapse had a material bearing on whether to grant the employees' request because of the burden to the carriers from the "retroactive" imposition of the conditions. "Retroactive" imposition of conditions was never an impairment in the past to imposition of protective conditions. See, e.g., *New York, New Haven & Hartford R. Co. Abandonment—Pomfret to Putnam, Conn.*, 312 I.C.C. 465 (1961).

In the two or so years since the *Knox & Kane* decision, the Commission has developed its anti-employee protection position to the point where it has declared a policy of *never* imposing protection in cases involving Section 10505 exemptions from Section 10901.

In a proceeding instituted by the Anacostia & Pacific Corp., a company formed to purchase lines of railroads under Section 10901 to avoid employee protection obligations, the Commission decided to "propose a class exemption [under Section 10505] for all acquisitions and operations under section 10901" [24] and clearly delineated its determination never again to exercise its discretion to impose employee protection under Section 10901:

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[23] *Knox & Kane R. Co.—Gettysburg R.—Petition for Exemption*, *366 I.C.C. 429 (1982)*.

"Finally, the only opposition to individual exemption requests has been from railroad labor seeking the imposition of employee protective conditions. We have consistently rejected these requests, reaffirming our long-standing, and judicially approved policy of not imposing labor protective conditions on acquisitions and operations under section 10901. We have stated that the policy of supporting continued operation of abandoned lines or abandonable rail lines is so strong that we will not impose labor protection even on established carriers acquiring or operating such lines. See e.g. *Tennessee Central Ry. Co.—Abandonment*, 334 I.C.C. 235 (1969); and Finance Docket No. 29923, *Acq. of Line of Chicago, R.I. & P. Ry.—Ft. Worth-Dallas, TX* (not printed), served June 3, 1982. It is our established policy that the imposition labor protective conditions on acquisitions and operations under 10901 could seriously jeopardize the economics of continued rail operations and result in the abandonment of the property with the attendant loss of both service and jobs on the line.[12] In conclusion, we would not impose protective conditions if an application or individual exemption were filed. We propose to follow that policy should this class exemption be adopted."

[12] See e.g., *Durango & S.N.G.G. CO.—Acq. and Opers.*, 363 I.C.C. 292 (1979), aff'd sub nom. *Railway Labor Executives Associations* v. *United States*, 697 F.2d 285 (10th Cir. 1983); Finance Docket No. 30505, *Alabama S.R.R. Co.—Alabama Gr. S.R.R. Co.—Acq., Oper., and Track Rts.* (not printed), served August 30, 1984; Finance Docket No. 30606, *MG Rail, Inc.—Exemption from 49 U.S.C. 10746, 10901, 11321 and 11343* (not printed), served February 1, 1985; and Finance Docket No. 30339, *Baltimore & O. R.R. Co.—Exemption from 49 U.S.C. 10901* (not printed), served December 20, 1983.

The Commission has extended its policy to refusing to impose protection on the carrier selling some 700 miles of railroad to a newly formed carrier because such protection would be a burden on the selling carrier.[25] In that case the I.C.C. held:

"Moreover, although the labor representatives made certain general allegations of potential harm to affected employees, they did not attempt to quantify this harm. On the other hand, ICG furnished an adequate estimate of the burdensome effect upon it if labor conditions were imposed. ICG also submitted a comparison of labor protection costs measured against the purchase price of the lines it will sell. Clearly, the equities do not weigh in favor of imposing labor protective conditions as a discretionary matter. Just as such conditions would be an undue burden on G&M, they would also impose a extremely heavy burden on ICG, since ICG has been unable to operate these lines profitably.[26] (See G&M petition at page 3).

"We also do not accept RLEA's argument that labor protective conditions should be imposed to carry out the policy of section 10101a(12) pertaining to the encouragement of fair wages and safe and suitable working conditions. RLEA has not demonstrated that the employees hired by G&M or retained by ICG would receive less than fair wages or be subjected to unsafe or unsuitable working conditions."

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[24] Ex Parte No. 392 (Sub-No. 1) *Class Exemption for the Acquisition and Operation of Rail Lines Under 49 U.S.C. 10901* (August 27, 1985). Attached hereto as Exhibit "B".

[25] *Gulf & Mississippi Railroad Corporation—Purchase (Portion)—Exemption—Illinois Central Gulf Railroad Company* (January 2, 1985), F.D. No. 30439. Attached as Exhibit "C" hereto.

[26] The "extremely heavy burden" argument was used by railroads repeatedly in the past as a justification for avoiding I.C.C. imposition of employee protective conditions. This is how the Commission always answered that argument before Staggers [*New York, N.H. & H. R. Co.—Abandonment*, 312 I.C.C. 465, 469 (1961)]:

> Applicants in other abandonment cases have argued, as does the carrier, that they were not in a financial position to absorb the costs of employee conditions and that compliance therewith would be costly and would defeat in a large measure the objectives sought to be obtained by the abandonment. See *Pacific Electric Ry. Co. Abandonment*, 275 I.C.C. 619, 676, and *Chicago N.S. & M. Ry. Co.—Abandonment*, 290 I.C.C. 765, 796. In the first-named of the foregoing cases we referred to an argument concerning the applicant's financial condition, similar to that advanced by the carrier herein, and stated:
>
> > That argument could be advanced in every abandonment case. The financial position of the applicant will be materially strengthened by the program involved although the realization of some portion of the benefits anticipated may be temporarily delayed by affording some protection to the employees adversely affected. In other cases of this character we have found that the employees adversely affected, in the public interest, should be afforded adequate protection. No persuasive reason for a different conclusion has been presented here.
>
> Likewise in the instant proceeding there has been no persuasive showing made that a different conclusion is warranted.

Proof of adverse effects to employees is no longer a criterion for Commission imposition of protection. A typical expression of the Commission's attitude toward employees under the Staggers Act is found in a decision issued March 21, 1985, denying the reopening of a case in which it was proved that employees would be adversely affected.[27]

"We find no material error in the prior decision. Since enactment of the Staggers Rail Act of 1980, Pub. L. 96-448, (Staggers Act), the Commission has construed 49 U.S.C. 10901 as not requiring the imposition of labor protective conditions, but as according us the discretion to impose them only where warranted. This view is consistent with that section's use of the permissive word "may" and the legislative history of the Staggers Act. For these reasons, the Commission has consistently declined to impose labor protection in exempting rail acquisitions governed by 49 U.S.C. 10901. See *Knox & Kane R. Co.—Petition for Exemption*, 366 I.C.C. 439, 441-42 (1982). Only in approved transactions under 49 U.S.C. 10903, 10910, or 11343 (involving abandonments, feeder line transfers, or consolidations) are we required by law to impose labor protection. In other types of rail transactions, we have concluded that the labor proviso of 49 U.S.C. 10505(g)(2) does not require us to impose protective conditions in the exemption of acquisitions of limited scope and minor public impact.

"The new evidence that certain WM employees may have been displaced does not of itself justify reopening this proceeding and raises no issues not already considered. Such adverse economic effects often accompany the transfer of lines, and in the prior decision, we gave due weight to RLEA's general comments concerning this possibility."

But the Commission has gone even further and in a proceeding brought under Section 10505 to secure an exemption from the requirements of Section 11343 in order to acquire trackage rights in which imposition of employee protection is mandated by Section 10505(g) and Section 11347, the Commission on its own motion converted the proceeding into a Section 10901 case despite the fact that the latter section applies only to purchases of rail lines. The only advantage achieved by this slight of hand was to evade the necessity of imposing employee protective conditions:[28]

"Although petitioner sought exemption from the requirements of section 11343 for these transactions, we are treating this petition under 49 U.S.C. 10901. Section 11343 is intended to apply to the possible anticompetitive effects of mergers and consolidations of existing rail enterprises. *Okmulgee Northern Ry. Co.—Abandonment*, 320 I.C.C. 637, 638, 639 (1964); and *People of the State of Illinois* v. *United States (Illinois)* 604 F. 2d 519, 524-25 (7th Cir. 1979), cert. denied, 445 U.S. 951 (1980). In contrast, section 10901 is intended to deal with the extension or acquisition of an individual rail line. It is essentially directed at the transportation activities of a single rail carrier where there is little danger of any adverse competitive consequences. *Application Proc.—Construct. Acq. or Oper. R. Lines*, 365 I.C.C. 516, 518 (1982). Here, there is little, if any, danger of adverse competitive consequences. We are dealing with short segments of rail line that have been out of service for over a year.

* * * * * * *

"Additionally, the Commission has a long-standing and judicially approved policy of not imposing labor protective obligations upon newly formed acquiring carriers. See, *e.g.*, *Chicago, M.St. P. & Pac. R. Co.*, 658 F. 2d 1149, (7th Cir. 1981) (the burdens on new operators are great enough without the additional costs of labor protection); *Durango & S.N.G.R. Co.—Acquisition and Operations*, 363 I.C.C. 292, 295 (1979), aff'd sub nom. *Railway Labor Executives' Association* v. *United States*, 697 F. 2d 285, 286 (10th Cir. 1983) (same); and *Simmons* v. *I.C.C.*, 697 F. 2d 326, 336-37 (D.C. Cir. 1982). Here ASR is a newly formed company and therefore labor conditions are inappropriate."

And so despite the history of employee protection before the Congress and the extensive and deliberate care taken by the Congress to protect employees affected by the Staggers Act, the Commission has imposed its contrary policy upon employees to insure that they will receive no protection except where Congress has expressly commanded it.

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[27] *Maryland Midland Group, Inc.—Exemption from 49 U.S.C. 10901 and 11301*, F.D. No. 30237 (March 14, 1985). A copy of this decision is attached hereto as Exhibit "D".

[28] *Alabama Southern Railroad Co., Inc. and the Alabama Great Southern Railroad Company—Acquisitions, Operations and Trackage Rights—Exemption*, F.D. No. 30505 (August 30, 1984). Attached hereto as Exhibit "E".

In addition, the Commission has ruled that while protection may be compulsory in abandonment cases under Section 10903 and will never be imposed by it under Section 10901, the Congress actually intended to *prohibit* employee protection in cases arising under Section 10905 where a line to be abandoned by a carrier is sold to another. In this latter ruling, the Commission has been upheld by a U.S. Court of Appeals.[29] This section is now also being utilized to avoid the use of employee protection arrangements.

Most recently—and for the first time in its almost 100 year history—the ICC has resorted to retroactive approval of an application (without notice, hearing or, of course, imposition of employee protective conditions) after privately informing the applicants' attorney of its decision and delaying for five days the publication and service of that decision upon interested parties, including those most affected: the employees whose jobs had been sold. (*Laurinburg and Southern R. Co., Etc.*, F.D. 30732; decided October 30, 1985, served November 4, 1985, effective November 1, 1985.) When it appeared to employees on October 31, 1985 that another railroad was taking over their work, the attorney for the unions called the ICC about 4:00 P.M. on November 1, 1985 to inquire as to the status of the case and was told the petition was pending and had not yet been approved. Another inquiry was made about 2:00 P.M. on Monday, November 4, 1985, and the attorney was again told that the petition was still pending and had not been approved. It was only after a union official confronted a vice president of the selling railroad with this information that the latter informed him that the I.C.C. had approved the petition the previous week. Union counsel then informed the Commission that a major labor problem was threatened because of the confusion regarding I.C.C. action and was then informed that the ICC had indeed approved the petition at 12 noon the previous Wednesday, October 30, 1985, but had not served it upon the parties until Monday, although making it effective the previous Friday.

It seems that the Commission may indeed have decided to deregulate its own procedural regulations, the requirements of the Administrative Procedure Act and perhaps even the due process clause of the U.S. Constitution in its zealous misunderstanding or disregard of the will of the Congress.

C. The Staggers Act, the Commission and the Railway Labor Act

The Commission's second method of relieving the rail industry of its "labor burden" has been to declare that in all matters affecting rail transportation it is supreme by virtue of the "exclusive and plenary clause" of Section 11341 [formerly § 5(11) of the Interstate Commerce Act]. This is a total reversal of direction and policy for the Commission. Whereas the Commission just before enactment of Staggers repeatedly held:

"[that] the Commission's subject matter jurisdiction [was] solely over matters affecting transportation services and [that the I.C.C. could] determine only that this provision and other provisions in the agreement would have no adverse transportation effects; that as to all other subject matters, including matters relating to labor relations as may fall within the purview of the Railway Labor Act the [Commission] decline[s] jurisdiction over such questions;"[30]

However, after Staggers, the Commission blatantly states:

"It is that [Commission] order, not RLA [Railway Labor Act] or WJPA [Washington Agreement], that is to govern employee-management relations in connection with the approved transaction."[31]

This statement is a far cry from that quoted just before on the same subject—and, significantly, the Commission does not argue that the earlier policy was misstated or otherwise erroneous. It is just that the Commission contends that its current policy reversal regarding employee rights and interests comports with with what the Congress indicated it wanted in the Staggers Act.

The Commission's usurpation of legislative authority recently has been rejected by the U.S. Court of Appeals for the District of Columbia Circuit[32] [761 F.2d at 723]:

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[29] *Illinois Central Gulf R. Co.—Abandonment—In Alexander Cty., Ill.*, AB-43 (Sub-No. 92), 366 I.C.C. 911 at 913-14 (June 2, 1983); affirmed *Simmons* v. *I.C.C., et al.*, 760 F. 2d 126, 129-130 (7th Cir., 1985).

[30] *ICG—Trackage Rts—C&IM*, F.D. 28046, February 22, 1977.

[31] *Maine Central Railroad Company, Georgia Pacific Corporation, Canadian Pacific Ltd. & Springfield Terminal Railway Company—Exemption form 49 U.S.C. 11342 and 11343, F.D. 30532.* (Sept. 13, 1985). Attached hereto as Exhibit "F". This all-encompassing supra-jurisdictional statement is based on the Commission's purported authority under Section 11341 but that provision does not apply in an exemption proceeding under Section 10505 by which the *Maine Central* case is governed.

[32] *BLE* v. *I.C.C.*, 761 F.2d 714 (Doc. Cir. 1985).

"The statutory language dictates that the Commission's exemption authority applies only "as necessary" to allow transactions to occur. 49 U.S.C. § 11341(a). Congress has given ICC broad powers to immunize transactions from later legal obstacles, but this delegation by Congress is explicitly qualified by a necessity component. The statute thus requires that the exemption authority operate according to necessity, not according to whim or caprice.

"This statutory limit on the Commission's authority creates certain responsibilities for ICC. In exercising its waiver authority ICC must do more than shake a wand to make a law go away. It must supply a reasoned basis for that exercise of its statutory authority.[4] "

But this clear holding of the Court of Appeals did not deflect the I.C.C. from the pursuit of its deregulation objective: the statement of the Commission quoted above at page 47 was made two months *after* the Court had spoken in the *BLE* case, quoted above at page 48, and rejected the I.C.C.'s arrogation of power to effectively repeal the Railway Labor Act.

More recently, the Commission was asked by the Santa Fe and Southern Pacific Railroads (SF/SP) in their merger case to convert the employee protection arbitration provision of Section 4 of the *New York Dock* protective formula into an interest arbitration proceeding and to force the employee into such an arbitration *before* the Commission decides whether to approve the merger. SF/SP's only justification for this unique and novel request is that it will make more money—a great deal more money—if the employees are forced to arbitrate their collectively bargained and Railway Labor Act rights prior to approval of a SF/SP merger.

There are three obviously fatal flaws in the SF/SP request: first, it is an absolute contradiction of Congressional policy against interest arbitration in the railroad industy beginning with the Arbitration Act of 1888 (see page 3, supra) and consistently maintained in every statutory enactment of that time to and including the Staggers Act; second, since *New York Dock* is a formula of conditions to be imposed upon an order approving a merger, the Commission is being asked to condition something that does not and may never exist—certainly not in the form proposed to the I.C.C at the time of the request; and, third, to grant the request would be to set aside provisions of the Railway Labor Act and the statutory and contractual rights of the employees without justification although in the name of "effectuation of the merger". The following statement was made by the Commission in 1967 and is typical of such statements repeatedly made by the I.C.C. prior to enactment of the Staggers Rail Act:

"Neither the Washington Agreement nor the specific collective bargaining agreements between these roads and their employees is such a restraint, for indeed section 5 transactions have been successfully consummated in full compliance with such terms. Cf. *Chicago, St. P., M. & O., Ry. Co., Lease*, 295 I.C.C. 696. The essential problem to be resolved is an accommodation of laws, a role not foreign to us in section 5 transactions. *Seaboard Air Line R. Co.* v. *U.S.*, 382 U.S. 154 (1965). When balancing the national policy as to transportation with that of labor relations, we "act in a most delicate area * * * [and] policies of the Interstate Commerce Act and the labor act necessarily must be accommodated, one to the other." *Burlington Truck Lines* v. *U.S.*, 371 U.S. 156 (1962).

"The designated "exclusive and plenary power" of the Commission in section 5(11) [now § 11341] cannot be so broadly construed as to brush aside all laws—be they statutorily created antitrust laws or voluntary contractual agreements made binding by the force of law." (331 I.C.C. at 170.)

The Commission, subsequent to the enactment of Staggers, has reversed course and, as noted above at pages 1 and 2, will undoubtedly grant the SF/SP request.

Clearly, the Commission will not again reverse its course unless the Congress compels it to do so.

The present Commission course is fraught with all of the disastrous consequences which the Supreme Court, this Congress and, prior to Staggers, the Commission itself foresaw would result from the unjust treatment of employees. The Interstate

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[4] This is not to say that the ICC must enumerate every legal obstacle that is waived in its approval. Such a requirement might undermine the approval authority's purpose of "facilitat[ing] merger and consolidation in the national transportation system." *County of Marin* v. *United States*, 356 U.S. 412, 78 S.Ct. 880, 883, 2 L.Ed. 879 (1958), because some legal obstacles to fruition of the transaction may not be entirely foreseeable at the time of approval. But ICC's decisionmaking process, either in the approval or in a later proceeding, must reveal evidence supporting a conclusion that waiver of a particular legal obstacle is necessary to effectuate the transaction.

Commerce Act must be amended if justice is to be done and those consequences avoided.

SOUTHERN PACIFIC TRANSPORTATION CO.,
San Francisco, CA, January 16, 1986.

Hon. BOB PACKWOOD,
Chairman, Subcommittee on Surface Transportation, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.

DEAR CHAIRMAN PACKWOOD: I would like to take this opportunity to present the views of Southern Pacific Transportation Company on railroad experiences under the Staggers Act and respond to contentions concerning Southern Pacific made at the Staggers Act oversight hearings held on November 1 and 4, 1985.

We, of course, concur in the statement and December 19, 1985 letter submitted by Mr. Dempsey on behalf of the Association of American Railroads. We believe that the Staggers Act has worked to the benefit of both the rail and the shipping industry. Through innovative and responsive pricing and service packages, the railroads generally have been able to maintain and improve upon both their financial and competitive positions in many market sectors and have provided better transportation alternatives for the shipping public.

An examination of factual experiences under the Staggers Act will bear out the overall benefits of this legislation in its present form and will clearly show that there is no need for any revision of the law at this time.

Some shippers and carriers have presented testimony describing "problems" allegedly arising from various railroad actions under the Staggers Act. Mr. Harold L. Gastler of the Missouri-Kansas-Texas Railroad Company on behalf of Railroads Against Monopoly was one such witness who specifically mentioned actions of Southern Pacific Transportation Company.

I believe, however, that a close scrutiny of these "problems" and a careful review of the specific facts involved will instead actually support and confirm the position of the Association of American Railroads and Southern Pacific that revision of the Staggers Act is unnecessary.

Mr. Gastler alleges that Southern Pacific enagaged in "anticompetitive joint rate cancellations". Specifically, Mr. Gastler refers to SP route closing actions generally involving the movements of lumber and other commodities between Oregon and California and the Southwest, intrastate movements within the State of Texas, and movements of lumber from Canada to Texas.

A careful review of the facts, however, will show that Southern Pacific did not take any anticompetitive action which foreclosed the MKT Railroad from participation in efficient joint rates and through routes, but instead SP operated to rationalize or simplify its route structure consistent with sound transportation economics while keeping the interests of shippers for competitve and efficient rail service paramount.

In order to review the route closings involving the movements of lumber and other commodities between Oregon and California and the Southwest, some brief background information is necessary to place these actions in the context of today's competitive transportation market.

For many years SP, in common with other western railroads, followed a practice of "open" joint routing, whereby shippers could move their rail shipments via any number of railroads over almost any possible combination of routings between a given origin and destination all at the same transportation rate. This practice evolved under a regulatory scheme which essentially required the equalization of rates over all alternate routes with such rates established by collective action in rate bureaus composed of competing carriers.

This system of collective joint-rate making and open joint routing served to inhibit price competition and encourage inefficiencies. In numerous cases one or more unnecessary carriers were included in a route, increasing operating and administrative costs. These inefficiencies made the railroad industry as a whole less competitive relative to other transportation modes.

The Staggers Act freed the railroads from some of these arbitrary regulatory and anticompetitive requirements. With the freedoms available under the Staggers Act, SP developed a program to analyze each of its traffic flows to ascertain if there were more efficient ways of handling the business. During this analysis, SP found that disproportionately high revenue losses and handling costs—including substantial movements of empty rail cars—were closely related to participation in rail movements by unnecessary bridge carriers (*i.e.*, railroads who serve neither the origin nor the destination but only "bridge" the traffic between the originating and terminating railroads in a joint route).

For example, Southern Pacific has a system of efficient long haul blocking practices (i.e., aggregating cars in trains in a certain order) whereby a rail car will be blocked for movements from the first rail yard closest to the origin to the rail yard on SP closest to the destination. Thus, the cars will be transported with no intermediate handling sometimes for 1,000 to 2,000 miles. The overall cost and operating efficiency of this type of handling is far greater than that resulting from the inclusion of another carrier in the route which requires the setting out and reblocking of cars at intermediate interchange points.

Also, empty car movements are particularly important to SP because of the geography of the railroad. Forming a vast crescent between the Pacific Coast and the Central United States, SP was particularly vulnerable to bridge carriers who would solicit a portion of the movement, take a division of the revenue for the entire movement, and then leave SP with the job of moving the empty car back for the next move. Southern Pacific might originate a car in California destined to a point which could be served by SP lines in Texas. Southern Pacific would provide the car and originate the traffic but be allowed to haul it only to a junction in California with another rail carrier which also went to Texas. The other carrier would then take the shipment to Texas and there be allowed by regulation to return the empty car to Southern Pacific in Texas, leaving SP with a costly 2,000 mile empty haul to return the car to California.

As stated above, SP's route simplification program was designed with these as well as other factors taken into consideration. The route simplification program was intended to improve SP's economic position in at least three ways: (1) by eliminating participation in inefficient and circuitous routes and by channeling traffic to more cost effective and fuel efficient routes; (2) by eliminating costly unnecessary rail interchanges; and (3) by mitigating the very substantial impact of empty return costs for railcars through the receipt of additional revenue from the loaded movement to help cover the empty return cost. But it must be noted that a paramount consideration in the program was to preserve joint routes wherever it appeared that these routes were required to serve the genuine transportation needs of shippers or receivers. Thus, the program had the general effect of eliminating inefficient routings while, at the same time, allowing SP to concentrate its energies on service over the remaining competitive route structure.

Again, it was not Southern Pacific's intent to cancel an efficient route needed by shippers to meet their legitimate transportation needs. Transportation alternatives were preserved to the maximum extent possible.

Turning now to Mr. Gastler's specific contentions, it should first be noted that the routing actions by SP are still subject to regulation and have been published in tariffs in accordance with ICC rules and regulations. However, MKT has *never* filed a protest with the ICC against SP's route cancellations, although there was ample opportunity to do so.

As part of the route simplification program, SP did close generally inefficient and little used routes on lumber in December, 1982 and on general commodities in March, 1983 between Oregon and California and the Southwestern States. Most importantly, however, Southern Paacific *retained* competitive routes involving other carriers *including MKT*. Where Southern Pacific did not serve the origin and the destination, all routes with all carriers (including MKT) remained in effect. Where SP served both the origin and destination stations, the shippers retained the alternative of routing via SP directly from origin to destination, or routing via Southern Pacific to Ogden, Utah and then other rail carriers, (including MKT) beyond Ogden to the destination. (In limited circumstances, routings were also available via SP to Portland, Oregon and then other rail carriers (including MKT) to the destination.)

Contrary to Mr. Gastler's assertions, "all" lumber routings were *not* cut off where SP served the origin and destination. Shippers and other rail carriers (including MKT) could—and did—continue to participate in numerous joint rates and through routes. The cancellations simply did *not* cut MKT out of all routes.

In connection with Mr. Gastler's example on Texas intrastate rates, the current intrastate tariffs provide essentially for equalized rates over *all* routes between any two points.

The impact of that rule results for example in a situation where SP may establish a rate from Houston Texas to Dallas Texas, and then have that same rate automatically apply via MKT and Missouri Pacific single line routes as well as all possible routes involving combinations of carriers between those same two points. There is simply no incentive to establish lower competitive rates if your competitor automatically gets the benefit of that rate adjustment by having that same lower rate simultaneously apply to its competitive movements. In order to be able to conduct route specific pricing and give shippers competitive alternatives, SP amended its participation in tariffs so that where SP served the origin and destination it could establish a lower rate without having that same rate automatically and contemporaneously apply for SP's competitor.

Obviously, the MKT is free to take the same action. Therefore, again using the Houston-Dallas example, if MKT wanted to establish a lower rate to attract business to its lines, it would receive the competitive benefits of that lower rate because SP would not automatically participate. Also, if MKT wished to match a lower rate set by SP, it could do so at any time. Again, MKT was not precluded from efficient intrastate movements.

The last example of Mr. Gastler involved movements from Canada to Texas. This traffic was routed via another rail carrier for interchange at either Kansas City or East St. Louis, SP's routes via both those gateways became effective November, 1982, and in connection with the Kansas City route, MKT participated in that route by receiving the traffic at Kansas City and delivering the traffic to SP at junctions in North Texas. However, this routing with MKT resulted in SP hauling the traffic at a financial loss. It was simply not compensatory to move the traffic via the Kansas City route with MKT's participation. Southern Pacific attempted to negotiate with MKT for a better division of revenue on the movement. However, SP's efforts failed, and SP substituted its direct route from Kansas City for the MKT-SP route in April, 1983.

The simple fact is that SP could not cover its costs in connection with joint routes with MKT via Kansas City. Our direct route from Kansas City is circuitous, but at least SP did not lose money handling traffic that way.

It should be stressed that this reluctance to participate in inefficient routes involving other rail carriers is a course of action not taken solely by SP. Attached is a representative list of requests made by SP to MKT for participation in certain joint routes which were denied. Southern Pacific has not made an exhaustive search nor kept voluminous records to document all of the numerous times that MKT has denied SP participation in a route where SP was not essential to the movement. However, these examples illustrate that MKT has pursued what we believe to be the same prudent course of action as most other railroads—to maximize its participation in efficient competitive routes for both its benefit and the benefit of its shippers.

In summary, the actions of Southern Pacific were motivated by a desire to give shippers competitive alternatives involving efficient and economical rail service, while, at the same time, covering the costs of providing that service. These actions were the same type of actions taken by MKT and other railroads to fulfill prudent management objectives.

I must add here that we believe that the Staggers Act was intended to protect competition and not any one individual competitor who may be otherwise inefficient or non-competitive. Consistent with that premise, Southern Pacific has operated in its route closing program to preserve competitive rail alternatives for shippers whenever economically possible and enhance competition by providing better and more responsive service.

These actions could only have been accomplished under the Staggers Act in its present form and only as a result of these actions have the railroads been able to offer improved services to the shippers.

Very truly yours,

J.P. EDWARDS,
Senior Vice President—Marketing and Sales.

William H. Dempsey
President

ASSOCIATION
OF AMERICAN
RAILROADS

December 19, 1985

Honorable Bob Packwood
Chairman
Subcommittee on Surface Transportation
Subcommittee on Commerce, Science
and Transportation
U. S. Senate
Washington, D.C. 20510

Dear Chairman Packwood:

Having had an opportunity to read all of the prepared testimony presented at the Staggers Act oversight hearings held by your subcommittee on November 1 and 4, and to review the transcript of those hearings, I am submitting these additional comments for the record. I will focus on the testimony of the coal and utility interests who were represented by Edward Mitchell (the President of PEPCO appearing in behalf of C.U.R.E.), Mark Cooper (appearing in behalf of the Consumer Federation of America), Donald Bellum (President of Cypress Coal Company appearing in behalf of the National Coal Association), and J. B. Flanders (General Manager, Arizona Electric Power Cooperative, appearing in behalf of the National Rural Electric Cooperative Association).

While Mr. Cooper claims to speak in behalf of this nation's consumers, it is to be noted that the American Public Power Association and the National Rural Electric Cooperative Association, whose members own and operate coal-burning utilities, pay dues to the Consumer Federation of America and have representatives serving among its officers and directors. Since Mr. Mitchell also claimed to be representing in his remarks the interests of electricity consumers rather than those of the utility he heads, it would not be inappropriate for me to presume to speak for the ultimate consumers of all commodities carried by the railroads and offer some observations as to their interests in preserving the Staggers Act.

The Need to Identify the Consumer's Real Interest. Given the organizational and financial ties to the electric utility industry of Messrs. Cooper and Mitchell, one can understand why they would ascribe to the consumer a very narrow interest in the railroad industry, viz., obtaining cheap coal rates. But these end-users of coal transported by rail are also end-users of other commodities transported by rail -- chemicals, fertilizers, grains, steel, aluminum, automobiles and auto parts, lumber, paper, fresh fruits and vegetables, soda ash, iron ore, and the contents of trailers and containers on flat cars, to name but a few. As end-users of all commodities moving by rail, I would maintain that their principal interest is in the creation and maintenance of an economically viable railroad system that can continue to provide the transportation services they need.

As consumers, they would no doubt like to obtain cheaper rail rates for all commodities, not just coal. They would also like to obtain cheaper automobiles, cheaper electricity, cheaper gasoline, cheaper heating oil, cheaper natural gas, cheaper groceries, and so on. But being rational consumers they realize that the producers of those commodities will continue to invest in

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production only if that investment is adequately rewarded. By the same token, they recognize that if railroad service is to continue to be available to transport all of the commodities they ultimately consume railroad investors will have to be adequately rewarded. Of course, to the extent an individual consumer ultimately consumes more of one commodity than another, he or she wants to be sure the rates on that commodity are not disproportionately high.

Therefore, speaking for the ultimate consumers of all commodities moving by rail, I would urge your subcommittee in exercising its oversight responsibilities to satisfy itself that returns to rail investors are not excessive, nor likely to become so, and that the rates on any particular commodity, especially coal, are not disproportionately high. It seems to me that those are the principal consumer issues involved in assessing the operation of the Staggers Act. In order to satisfy itself on those two points, the subcommittee must deal with facts, not half-facts, fabrications and unsupported assertions. And that observation brings me to an examination of the Bellum-Cooper-Mitchell-Flanders testimony.

The Bellum Testimony. I would not deny to any witness, including myself, the right to present the facts in their best light. Mr. Bellum's testimony is a good example of that right being exercised to the fullest. Thus, citing data from the ICC and Energy Information Administration, he testified that from 1975 to 1983 "...average rail rates per ton-mile for movement of coal increased by 53 percent whereas the average price of coal at the mine increased only 35 percent." That statement is absolutely correct. But Mr. Bellum neglected to inform the subcommittee that in the single, immediately preceding year of 1974, the price of coal increased *84.6 percent* while the average rail coal rate per ton-mile increased only *15.6 percent.* Had Mr. Bellum chosen to reveal more of the facts, he would have advised the subcommittee that between 1972 (the year prior to the OPEC oil crisis) and 1984 (the latest year for which data is available), the mine-mouth price of coal increased by *233 percent* whereas the average rail coal rate per ton-mile increased only *109 percent*.

Mr. Bellum attached to his testimony several charts indicating increases in rail productivity and stated that those increases warranted the lowering of rail coal rates.. If one looks at data which Mr. Bellum does not provide it can be shown that rail rates have in fact been lowered in real terms. On a constant dollar basis (adjusting for inflation) rail revenue per ton-mile has decreased 34 percent since 1972 and 28 percent since 1975.

As I said, there is nothing wrong with the facts presented by Mr. Bellum; the problem lies in the selectivity of the presentation. The problem with the testimony of Messrs. Cooper and Mitchell is a much more serious one. They present as "facts" the results of various studies and analyses which they, or the organizations they represent, have prepared. Without exception those studies and analyses have been shown to be seriously flawed -- and they or the organizations they represent have been advised as to the nature and extent of those flaws. Such advice has not led to any amendment or correction of the studies and analyses or, in subsequent references to them, even to words of caution as to the possibility of doubt (let alone error) in the findings. In the case of Mr. Cooper, the critiques of his studies were noted in his testimony and summarily swept aside. Being a party to the dispute, I suppose AAR should expect that its opponents would sweep aside its comments. But, as shown below, the more telling criticisms came from a source that cannot be dealt with so easily.

The Cooper Testimony. The substance of the Cooper testimony rests on the studies which he released last April and which were appended to his testimony. Those studies repeatedly cited for authority Professor Theodore Keeler, an economist at the University of California noted for his work on the economics of rail transportation. Therefore, last spring we asked Professor

Keeler to comment on the Cooper studies. His comments were very critical and cast doubt on much of Cooper's work. Mr. Cooper issued a rebuttal to the Keeler critique. We asked Professor Keeler to comment on the rebuttal. He again questioned most of Cooper's reasoning and factual assumptions. That critique was sent to Mr. Cooper following a hearing last September before the House Energy and Commerce Committee. Both of the Keeler letters were attached to my written testimony and I will not further burden the record by appending them here. But I would like to compare*/ some of the assertions in the prepared testimony of Cooper with the Keeler comments on similar assertions appearing in the Cooper studies and subsequent rebuttal to Keeler:

Cooper - Rates for coal are held far above costs under the illusion that the railroads are revenue inadequate, when in fact, several are more than revenue adequate. (p. 6)

Keeler - The CFA ... cites my work on the viability of the railroads a number of times in its attempt to document that the industry is sufficiently viable as not to require further rate increases. I believe that the conclusions they draw from my work (and from other sources, as well) are inaccurate, for several reasons. (6/19/85)

Cooper - We have documented the basic conditions of an unrestrained abuse of market power. (p. 6)

Keeler - If the CFA wanted to regulate away all instances of differences between prices and some measure of costs, they would have to regulate most of the economy. The CFA reports assert that variations in price-cost margins among users are at best necessary evils, and should be kept to a minimum through regulation .... This viewpoint is not consistent with the economic incentives of a workably competitive society. (6/19/85)

Cooper - The railroads are obviously healthy and those that are taking the lion's share of the monopoly rents probably never needed much recourse to the extraordinary measure of price discrimination. (p. 7)

Keeler - The evidence does not support the assertion that the railroads are now doing "extremely well" financially. And it certainly does not support the view that the major coal railroads are earning excess rents, or that they would earn excess rents (at least in economic terms) if they earned an opportunity cost of capital on the replacement value of their assets.

* * * *

The CFA rebuttal fails to show that economies of traffic density no longer warrant differential pricing. (9/17/85)

Cooper - Moreover, the analyses of the railroad industry, conducted during the late 1970s and based on data from the early and mid-1970s indicated that freight density was the key to financial viability for the railroad industry. Changes in density since then clearly indicate they must be approaching revenue adequacy.

* * * *

Since coal rates covered their costs before this growth began [in 1975], and economies of density existed over the range of increase (although they may now have been exhausted), this suggests an astronomical increase in profitability. (p. 10)

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*/ The references following the quotes are, in the case of Cooper, references to the pages of his prepared testimony and, in the case of Keeler, references to the dates of his two letters to me.

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Keeler - Unfortunately, the CPA does not document its assertion that the major coal-hauling railroads have traffic densities sufficient to exhaust (or even come near exhausting) economies of density. This assertion obviously warrants further empirical investigation, investigation which I have pursued....

* * * *

Railroad	1982 density	1983 density
	(millions of net ton-miles per route mile)	
Burlington Northern	5.5	6.1
CSX	4.5	4.7
Norfolk Southern	5.1	4.8
Union Pacific	5.2	5.3

The results provide no evidence at all that the relevant railroads have reached minimum efficient density. Indeed, with the exception of the Burlington Northern in 1983, no railroad has surpassed a density of 5.5 million net ton-miles per route-mile, little more than half the minimum efficient density of 10 million discussed above as being most likely relevant to coal. (9/17/85)

Cooper - The third of our major studies looked at the general relationship between costs and rates for transporting coal. We reviewed evidence on the existence of market power and its actual exercise. These included both econometric studies of the extraction of monopoly profits by railroads on coal transportation and accounting studies of the cost of moving coal for individual carriers and for the industry as a whole. We concluded that, at present, price discrimination has resulted in rates that are, on average, 30 percent above costs. (p. 11)

Keeler - The CPA reports do not accurately characterize optimal rail pricing. The basic thrust of the CPA's argument ... is that to meet the joint goals of efficient pricing and financial viability of the railroad industry, it should not be necessary for prices to exceed marginal costs (the extra costs of accommodating an extra unit of traffic) for very much traffic. This is contrary to the view of many others (including myself) that efficient pricing with an adequate return for the railroad industry requires considerable variation in ratios of price to marginal cost among commodities, and that rates for many commodities will have to be above marginal costs.

* * * *

[T]he CPA seems to be equating the rents accruing through differential pricing with monopoly rents accruing through monopoly pricing, i.e., pricing in excess of the level required to cover costs based on the replacement value of assets. I disagree firmly with this view. Rather, I believe that if the rates a railroad charges to a shipper do not exceed the (properly-defined) stand-alone costs for that shipper (or for a consortium of shippers of like commodities on the same route), and if the overall return to the railroad does not exceed its cost of capital ... then the railroad is not earning monopoly rents. (6/19/85)

Cooper - [A proper revenue adequacy test would] apply the accounting procedures and concepts that are applied by virtually every other regulatory body in the nation. The use of net book historical costs, the preclusion of a return on deferred taxes, the use of embedded cost of debt, and a focus on return on equity, are the common practices that are applied not only in regulated industries, but in unregulated industries as well. (p. 8)

* * * *

[The ICC's revenue adequacy test] attributes a level of revenue need to the railroads that is simply out of touch with reality. We're convinced that if the revenue adequacy test were reasonable, the extremely high profitability would be apparent. (p. 12)

Keeler - In my comment on the initial CFA reports, I stated that in long-run competitive equilibrium, an industry will generally earn an opportunity cost of capital based on the replacement value of its assets. Indeed, in any competitive industry, in the long run, prices are determined by the cost level of a new-entrant firm. And new-entrant firms will enter an industry only if they can earn an opportunity cost of capital (i.e., the return they could get in other industries of equivalent risk), based on a current, or replacement value of their assets. Because a new firm must in fact pay current or replacement value for whatever assets it buys, it cannot buy new (or even used) assets at the "book" or "historical" values of "mature" firms. (9/17/85)

* * * *

The CFA Report does not show the major coal-hauling railroads to be revenue-adequate. (9/17/85)

Cooper Even if the ICC had gotten the revenue adequacy determination correct, the guidelines it has adopted for setting maximum rates would be unacceptable. (p. 12)

Keeler - [T]he CFA paper seems to suggest that a stand-alone rate ceiling based on a new entrant's costs would generate excessive or monopolistic rents. This is puzzling, because in long-run equilibrium, prices in competitive markets are based on costs for a new entrant. Would the rents generated by changes in prices in these competitive markets also qualify as monopoly rents? If the CFA chooses to call such rents monopoly rents, it has a unique definition of monopoly rents.

The issue as to how stand-alone costs should be defined is too complicated to go into in the detail it deserves here, but I must point out that what the CFA has said about stand-alone costs does not seem to me to follow from the analysis or evidence they give. It certainly does not follow that the railroads are earning monopoly rents, and in any event, I strongly believe that existing laws and regulatory forums are adequate for resolving these issues. (6/19/85)

Cooper - Excess profitability is apparent in the form of huge spin offs of monopoly profits into other industries. (p. 6)

Keeler - In its earlier paper on the financial condition of the railroad industry, the CFA took the fact that many railroads are investing in non-rail subsidiaries as evidence that railroads are earning excessive profits. The point of my comments on the CFA report was that there is no connection between a firm's profit level and its tendency to spin off assets into subsidiaries in different lines of business; the decision to do so could as easily occur when a firm has too low a profit level as it could if a firm were earning a normal or excessive level. I took the case of the Penn Central as the most extreme case of a firm earning an inadequate return spinning off its assets in such a way. If in fact a firm could spin off assets when earning an inadequate, adequate, or excessive return, it follows that such behavior is totally irrelevant to the question as to whether the firm is earning an excessive return. (9/17/85)

Cooper - HAVE YOU EXAMINED THE FINANCIAL PERFORMANCE OF THE MAJOR COAL HAULING RAILROADS IN THESE TERMS?

Yes, one of the studies we conducted focused on the financial performance of the major coal hauling railroads (p. 9)

Keeler - To further support their argument that the railroad industry is currently in excellent condition, the CFA cites evidence from Forbes magazine (p. 3). The evidence they cite compares major railroads with the top 1000 firms. They assert that "As a group, railroads rank in the middle of the pack [Forbes' top 1000 corporations]. An average of the median rankings for railroads in 659. The coal railroads did much better, ranking closer to 500." Based on reference to Exhibit 3, p. 12, it would appear that for these rankings, the CFA is relying on one measure of railroad financial performance, net profit margin. This measure is not a meaningful basis for comparison across industries, given that capital intensities may differ. A much more reliable (though far from the best possible, as explained above) indicator of financial performance is return on equity. On that basis, the average coal railroad would rank 635, and no coal road would rank better than 553, compared with an average among all railroads of 649. Since there are 1000 firms in the sample, the median firm would have had a ranking of 500, so that all railroads, coal and otherwise, ranked well below the median on this count. This does not lend much support to the CFA's claim that coal roads are significantly more profitable than other railroads, and it certainly does not support the view that either the railroad industry or coal railroads earn abnormally high (i.e., monopoly) profits.

* * * *

The CFA failed to rebut my point that none of the major coal-hauling railroads managed to earn even the median return on equity in the 1985 Forbes survey of major corporations . And even these returns on equity may present too optimistic a view of the railroads' financial status, because return on all invested capital is a more appropriate criterion than return on equity, and, based on the very Forbes survey cited by the CFA, only one of the four large coal railroads (the Norfolk Southern) had a debt-equity ratio lower than the median for all 1,000 firms in the sample. But debt-equity ratios are not the important issue here. The important point is that whatever measure of return on investment one uses, railroads (including the major coal-hauling lines) have not reached the median earnings levels of equivalent firms elsewhere in the economy. This is not the place for detailed discussions of how much further they have to go, but they do still have a ways to go before they reach equivalent levels. (9/17/85)

The facts, theories and definitions of economic terms appearing in the Cooper studies having been called into serious question by Professor Keeler, I think it incumbent upon Mr. Cooper, in presenting the same materials to the Congress, to do more than assert that the criticisms were invalid because they "either misstated our argument or misapplied it." If Professor Keeler's critiques are sound, the Cooper studies are not worth the paper they are written on and should cease to be circulated as credible documents. If Mr. Cooper wishes to argue that the Keeler critiques are not sound, he should meet the issues head on and with specificity. For example, in the face of Keeler's statement (backed up with figures and citations to their sources) that no railroad is much more than halfway to a level of minimum efficient density, Cooper still proclaimed in his testimony that "Changes in density since [the mid-1970s] clearly indicate [the railroads] must be approaching revenue adequacy." If the subcommittee is to deal with the Staggers Act controversy on the merits, the argument presented has to rise above that level.

The Mitchell Testimony. The same kind of problem arises in Mr. Mitchell's testimony. At page 11 of his prepared statement, Mr. Mitchell refers to an Edison Electric Institute analysis of the profitability of 19 specific coal movements, which is appended to his statement. Last September we prepared an extensive analysis of these cases and identified substantial errors both in the methodology and in the data employed. Our up-dated critique is enclosed (Enclosure #1). It was sent originally to the Department of Energy and subsequently to the E.E.I. and C.U.R.E.

I will not dwell on the methodological problems in the E.E.I. analysis but refer you to the discussion beginning on page 2 of Enclosure #1. Even if the underlying data were errorless, the flaws in the methodology would preclude the generation of meaningful results and that fact alone should have sent E.E.I. and C.U.R.E. back to their computer terminals.

But the underlying data is not errorless. We have noted numerous errors, *e.g.*, depicting as "current" a cost level lower than that existing in 1977. With knowledge of both the methodological and data problems, one would not expect to see the same analysis once more offered up to the Congress as evidence of how the railroads have abused their powers under the Staggers Act.

At the hearing on November 1, the ICC supplied for the record its Bureau of Accounts' analysis of EEI's 19 cases. It identifies one of the principal methodological flaws -- the use of system-wide average costs -- and notes that such costs "...may bear little resemblance to the peculiar operating characteristics and actual cost of transporting a particular shipment."[*] Perhaps this added criticism will be sufficient to quash further offerings of these 19 cases as proof of the railroad abuses allegedly suffered by captive coal shippers.

Mr. Mitchell provided in his testimony several other examples of how the railroads have allegedly abused captive shippers. I would like to comment briefly on those.

The Pepco Example. Mr. Mitchell states that PEPCO's coal rates increased about 80% in the 1979-84 period but that "general inflation" increased only 43% and electricity rates only 32.6%. We calculate that the GNP deflator increased 48% but, in any case, the appropriate index to measure cost increases affecting railroads is the Railroad Inflation Index and it increased 68% in the period. He also notes that PEPCO's complaints to ICC have been pending since 1980. Conrail advises me that of the pending challenges to PEPCO's rates, at least one is being held in abeyance at the request of PEPCO and over the objection of the railroads. But more importantly, I am advised that on October 23, 1985, a Conrail/PEPCO coal rate contract was filed with the Commission and that, upon approval, it is anticipated that PEPCO will dismiss its pending complaints.

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[*] The ICC also submitted the Bureau of Accounts' evaluation of the CFA studies and a C.U.R.E. study on the railroads' financial condition. It concluded that "the two studies do not accurately depict the financial condition of the railroad industry or validate C.U.R.E. and CFA's allegations that the railroads have abused their captive shippers."

The Kansas City Power and Light Example. Mr. Mitchell states that the rate to the KCPL Iatan Station has increased 47% since Staggers while the Railroad Inflation Index has increased only 27%. Those figures are approximately correct. The Burlington Northern advises me that there were rate increases aggregating 28.7 percent in the period October 1980 to January 1982 which were necessary to bring the movement to Kansas City Power and Light's Iatan plant up to an acceptable level of profitability; but the aggregate increase since January 1, 1982 has been only 10.6 percent. They point out further that a contract to cover the movement is now in the negotiation stage.

The Iowa-Illinois Gas & Electric Example. Mr. Mitchell states that the rate to Iowa-Illinois' Louisa plant increased 12 percent between 1982 and 1984 while the minemouth price of coal decreased 35 percent. The Burlington Northern advises me that the rail rate did increase 12 percent but notes that increases in the retail rates for electricity were of a similar magnitude and that the relevance of the rate increase to the minemouth price of the coal consumed is no clearer in one case than in the other. Each producer involved has its own distinct set of costs which it must attempt to cover with the rate or price charged.

Mr. Mitchell also notes that the minemouth price of coal to Iowa-Illinois' Riverside plant increased 23 percent while the rail rate rose 50 percent. The Burlington Northern advises that the rail rate actually rose only 40 percent. But, again, the relevance of the comparison is superficial. One could as well suggest that there is something amiss in the coal industry because the minemouth price of coal to Riverside increased 23 percent while the minemouth price of coal to Iatan decreased 35 percent.

The Southern California Potato Growers Case. Mr. Mitchell claims as "captives" some California potato growers who were allegedly abused by a 70 percent increase in boxcar rates. This "case" was also presented in a Senate Judiciary Committee hearing last September. Subsequent to that hearing, the president of the Southern Pacific railroad responded fully to the allegations in a statement to the Committee. A copy of that statement is enclosed (Enclosure #2) and here I will highlight only a few of the points made:

1. The so-called captive potato growers in California shipped 69 percent of their crop by truck in 1984.

2. California potatoes move only during a two-month period because, unlike Idaho growers, the California growers do not have cold storage facilities. Thus, the special rail equipment necessary to handle the California crop is idle ten months of the year unless alternative uses for it are found.

3. Shippers were offered contracts which provided reduced rates in exchange for volume guarantees. Those rejecting a contract were deliberately accepting the risk of higher prices in the spot market.

4. Even at the spot market price, the revenue-to-variable cost ratio of the rate was well below the jurisdictional threshold for rate regulation and, therefore, conclusively presumed to be constrained by competition.

5. Even though it is deregulated, the revenues from the fresh produce traffic has been insufficient to pay for replacement of the refrigerated equipment being utilized.

6. The subsidiary of the Southern Pacific responsible for marketing and providing transportation for perishable commodities lost $9.9 million last year.

A group that ships most of its product by truck, uses rail equipment during only two months of the year at rates below 180% of variable cost, and refuses to enter into contracts offering lower rates in exchange for volume guarantees, is hardly in a position to complain about abuses of railroad power. That the coal and utility interests can proffer such a complaint as an example of abuse does not, however, surprise me.

Mr. Mitchell goes on, in the case of the potato growers, to claim that the railroads are trying to cut off all legal remedies that might be available to shippers of exempt commodities. For that proposition, he cites a case involving a Conrail petition to the ICC for a declaratory order. Conrail advises me that the order it is seeking would have the ICC retain jurisdiction over exempt commodities or movements so it can order regulatory relief where appropriate.

The Montana Grain Example. Mr. Mitchell cites a Montana grain case pending before the ICC where the rates are alleged to be excessive but, because of delays in deciding the case, the farmers continue to pay those rates. Whether the rates in this particular case are excessive is a matter yet to be decided. As to the delay, I would point out that, in this and other pending cases where the shipper ultimately prevails, reparations are payable for the full period the unlawful rate was in effect. I would also point out that, with respect to the grain rates generally prevailing in Montana, a recent study by the Upper Great Plains Transportation Institute finds that since the Staggers Act the rates have declined 17.2%. The Burlington Northern estimates that, based on the 1984-85 crop year, this decrease translates into annual savings in freight rates of $18,295,000.

Whatever the merits of the particular case to which Mr. Mitchell refers, it is clear that the farmers in Montana have benefitted substantially from the Staggers Act.

The Colorado Switching Charges Example. Mr. Mitchell also refers to complaints in Colorado of excessive grain switching charges. I am advised that the Burlington Northern and Union Pacific railroads have entered into an agreement that has substantially reduced switching charges in Colorado and eliminated the source of any complaints.

The Amax Chemical Company Example. Mr. Mitchell states that Amax had to close a phosphate mine in Florida because of a 100 percent rate increase by the Seaboard System Railroad. The facts as reported to me by the Seaboard are quite to the contrary:

- Two rates are involved, one for interstate movements (which carried 90% of the traffic) and one for intrastate movements (which carried 10% of the traffic).

- Effective April 1, 1984 the interstate rate was increased 37% and the intrastate rate was increased 12%. There was no 100% increase.

- After these increases, the revenue to variable cost ratio of the interstate rate, as calculated by Seaboard, was only 128% and, as calculated by Amax, only 142%.

- Even under Amax's calculation the rate was far below the market dominance threshold so the Florida Commission found it had no jurisdiction to hear Amax's complaint.

- The 12% increase in the intrastate rate (which moved only 10% of the traffic) raised the revenue to variable cost ratio of that rate to 200%. The Florida Commission ordered the increase removed and, subsequently, Seaboard and Amax settled their differences amicably.

- Amax did not close its mine because of a rail rate increase. Amax had purchased the mine in 1980 from another firm and closed it in April 1982 (two years before the rate increases in question), presumably because of adverse market conditions. It reopened the mine in June 1983 and closed it again in October 1984 -- again, presumably because of adverse market conditions. The fact is that the plant which the mine serves is an old plant and lacks the efficient production processes of other plants in the area.

The Flanders Testimony. Mr. J. B. Flanders, General Manager of the Arizona Electric Cooperative, testified at length on "AEPCO's experiences with the railroads and the ICC since the mid-1970's" to illustrate why the situation under Staggers "cries out for Congressional correction." His testimony can be summarized as follows:

1. The Santa Fe is the originating carrier and the Southern Pacific is the delivering carrier.
2. A rate for the move of $5.80 was "discussed" in 1973.
3. In 1977, AEPCO asked ICC to prescribe a rate of $4.67/ton.
4. The ICC approved a rate of $8.64.
5. The rate was "enormously profitable" because, "according to AEPCO's evidence, the carriers' cost of providing the service was close to $4.00 per ton."
6. The case has been in various stages of litigation since 1980 and is awaiting ICC action.
7. The present rate of $15.83 is "some *273%* higher than the 1977 rate of $5.80 which -- in our view -- was *itself* unreasonably high."
8. When measured against other Western unit train movements, the rate is clearly excessive.
9. The impact of high rail rates is striking in view of AEPCO's general financial situation -- it lost $11 million in 1983 and laid off employees, froze wages, etc.
10. Because of the loss, it was forced to seek a service rate increase -- "we cannot run net revenue losses every year and survive."

All in all, Mr. Flanders tells a pretty grim story. I asked the Southern Pacific to comment on Mr. Flander's account. Based on those comments, a somewhat different picture emerges:

1. Mr. Flanders' account is substantially correct up to the prescription of the $8.64 rate in 1977. But he calls that rate "enormously profitable" based on AEPCO's evidence that the cost was "close to $4.00 per ton." The fact is the ICC *determined* that the cost was $5.44, yielding a revenue to variable cost ratio of only 159% (rather than the 216% figure yielded by Mr. Flanders $4.00).

2. Having posited a cost $1.44 below the ICC-determined cost in order to show an "enormous profit" in the ICC-approved rate of $8.64, Mr. Flanders later represents the rate offered in 1973 ($5.80) as the rate in effect in 1977 and compares it with the current rate of $15.83 to show an increase of "some 273%." The correct figure, of course, would be 83%.

3. But even the 83% figure is not correct. The 1977 rate of $8.64 was based on an annual volume of 1,000,000 tons. Because of AEPCO's inability to meet that volume, a new rate was published in 1983 for a 600,000 ton annual volume. The current rate of $15.83 is for the 600,000 ton volume. Were AEPCO to resume receiving 1,000,000 or more, its rate would be $15.31. That rate represents only a 77% increase over the 1977 base rate.

   The 77% increase is to be compared with an increase in the rail cost index over the same period of 76.8%. The railroads involved have never utilized the "zone of rate flexibility" freedoms under Staggers (sections 203(c) and (d)) to raise the rate above the inflation level. Under that authority it could have been increased annually as much as 6% above the inflation rate.

4. Mr. Flanders' contention that the rate is "clearly excessive" when measured against "similar movements" rests on a strained use of the word "similar." Most of the moves he cites are at least twice as long as the move in question--six being from Wyoming and one being from Colorado. It is a well-known fact that most rail rates have a built-in "taper" in which the rate per ton-mile decreases as the distance increases.

   During the initial litigation with AEPCO, the railroads submitted evidence on seven high-volume coal movements which originated from or near the McKinley Mine in New Mexico. That mine is approximately 19 miles south of the Mentmore Mine, which has been AEPCO's primary source of coal. The rates introduced by the railroads represented a well-established coal rate structure from Gallup, New Mexico coal fields and provided a proper basis for comparison with AEPCO's rate. The Commission was unequivocal in its acceptance of that rate comparison evidence and in its rejection of what it termed "AEPCO's allegedly comparable rates" which, as here, were from coal fields far distant from the Gallup fields.

5. Mr. Flanders makes much of high rail rates as a contributor to AEPCO's poor financial condition. He mentions nothing about the price of coal. I can only assume that the omission is due to the fact that the coal comes from a mine leased by AEPCO. AEPCO's Annual Report sets forth the delivered price per ton of coal for the years 1979 through 1984. Those prices as well as the average rail rate for each of those years and the ratio of the rail rate to delivered price are set forth in the following table:

	Delivered Price Per Ton of Coal	Average Rail Rate Per Ton of Coal	Rail Rate as a Percentage of the Delivered Price
1979	$34.86	$ 9.84	28.2%
1980	40.07	11.68	29.2
1981	48.03	13.46	28.0
1982	54.70	14.48	26.5
1983	58.73	14.81	25.2
1984	55.26	15.80	28.6

As shown by this table, the transportation price charged by the railroads has remained remarkably stable as a percent of the total delivered price of coal incurred by AEPCO, with the percentage actually declining in three of the five years since 1979.

Mr. Flanders asserts that rising rail rates were a "strong contributor" to the increased cost of power generation. It would appear that a much stronger contributor was the rising price of coal from the mine AEPCO leases because, while the rail rate increased $5.96 per ton over the period, the price of coal increased $20.40 per ton--more than three times as much.

6. Finally, a word on Mr. Flanders' observation that AEPCO lost money in 1983 and "was forced to seek a service rate increase." It is to be noted that the Southern Pacific incurred deficits in 1982, 1983 and 1984. Unfortunately, it cannot run to the ICC and "seek a service rate increase"; it has to take what the market offers.

   Flanders states that AEPCO even laid off employees to stem its losses. It had 268 employees in 1980 and 269 employees in 1984 -- a net reduction of one employee. What it did was lay off in 1983 the employees it hired in 1981 and 1982. The Southern Pacific, on the other hand, has laid off almost 11,000 employees between January 1, 1980 and September 1, 1985 -- going from an employment level of 36,103 to 25,281.

7. A somewhat more honest statement of the cause of AEPCO's financial difficulties is contained in its 1984 Annual Report:

> "Less than a decade ago, growth for demand and energy in the electric utility industry was predicted to double every ten years. The oil embargo of 1973 and claims of drastic domestic natural gas shortages caused some of these predictions. In response, electric utilities set out on a crash building program to meet these predicted demands for electricity.
>
> "What was not predicted was a massive international and national economic downturn and the effects of upward costs of energy and gigantic conservation programs by organizations and individuals.
>
> "As a subsequent result, utilities have found themselves with new units being under-utilized. The fixed costs for these new units must be paid every month, but the income has been insufficient to pay the bills, so the utilities are out in the marketplace scrambling for new business. And AEPCO is among them."

I would be happy to put to a jury the issues as to whether the Southern Pacific's or AEPCO's financial needs were the more serious, and as to whether, as Mr. Flanders claims, AEPCO's experience with the railroads under Staggers "cries out for Congressional correction." I would submit that the only thing crying out for correction is his testimony.

Testing the Utility Interests' Claims as to Rail Profitability. Both Messrs. Cooper and Mitchell attack the ICC's revenue adequacy standards as masking the true economic well-being of the railroads. Mr. Mitchell states: "If practices generally applied by utility regulatory commissions were applied, a far more realistic view of the railroads' economic health would emerge." Mr. Cooper asserts that "...if the revenue adequacy test were reasonable, the extremely high profitability [of the railroads] would be apparent." They both support the changes proposed in the C.U.R.E. bill which would value all assets at the original cost depreciated,*/ exclude deferred taxes from the investment base, and require the use of the embedded cost of debt in determining the cost of capital. While, for reasons explained at length in the ICC's decision establishing the revenue adequacy standard, the C.U.R.E. approach is not economically sound, we thought it would be helpful to your subcommittee's understanding of the issue to show the inadequacy of the railroads' earnings even under the C.U.R.E. proposal. The following table presents for the last five years a comparison of the results under the ICC method, and the C.U.R.E. proposal for the five largest railroad systems (excluding Conrail):

Return on Investment

1. ICC Method (deferred taxes included in the investment base)
2. The C.U.R.E. Method (deferred taxes excluded from the base)

			1980	1981	1982	1983	1984
BN		1.	6.27%	4.63%	4.41%	7.99%	9.57%
		2.	6.69	5.04	4.90	10.37	12.71
CO)	CSX	1.	6.76	5.38	5.33	5.53	5.06
		2.	8.68	7.22	7.49	8.53	7.76
BO)		1.	3.82	2.72	0.91	0.39	3.79
		2.	4.11	2.97	0.99	0.46	4.44
SBD)		1.	6.52	5.07	3.25	5.74	6.80
		2.	7.52	5.54	3.62	6.85	8.20
N&W)	Norfolk Southern	1.	9.74	10.74	8.01	5.39	6.16
		2.	12.09	13.59	10.54	7.71	8.97
SRS)		1.	8.56	8.61	5.54	4.78	6.08
		2.	10.17	10.55	6.97	7.19	9.06
SF)	Santa Fe/ Southern Pacific Corporation	1.	7.01	5.00	2.66	3.70	4.38
		2.	8.21	5.85	3.13	4.67	5.56
SP)		1.	2.61	0.50	-3.36	0.07	2.16
		2.	3.11	0.59	-3.98	0.09	2.57
SLSW)		1.	5.80	3.93	4.20	1.45	3.30
		2.	7.40	5.06	5.54	2.02	4.65
MP)	Union Pacific System	1.	8.12	7.98	6.03	5.23	5.15
		2.	9.31	9.43	7.42	6.99	6.93
UP)		1.	7.79	7.41	4.43	3.86	4.21
		2.	9.79	9.53	5.87	5.52	6.11
WP)		1.	3.28	-10.14	-7.16	-8.40	0.18
		2.	3.28	-10.37	-7.37	-9.24	0.20

NOTE: Under the ICC method, track is accounted for on a retirement-replacement-betterment basis. Under the C.U.R.E. method, track is accounted for on an original cost depreciated basis. It is not possible to calculate the track investment on an original cost depreciated basis for years prior to 1983. Therefore, for the years 1980-82, track is accounted for on an RRB basis in line 2 as well as in line 1.

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*/ Under the ICC method all assets are valued at the original cost depreciated except track which is valued on a retirement-replacement-betterment accounting basis.

Under the ICC method, the cost of capital in the years 1980-84 was 12.1%, 16.5%, 17.7%, 15.3% and 16.0% respectively. Under the C.U.R.E. method (using embedded rather than current debt costs), the cost of capital for those years would be 11.2%, 14.6%, 16.1%, 14.3% and 15.0%, respectively.*/

It is seen that, under the ICC method, no railroad earned a rate of return equal to the current cost of capital (the test for revenue adequacy) in any year. But we also see that, except for the Norfolk and Western in 1980, the same is true using the C.U.R.E. method. In 1984, the Burlington Northern comes closest -- a 12.71% return versus a 15.0% cost of capital. The year 1984 yielded the highest returns to the railroads since the 1920s. It was a banner-year. But even under the C.U.R.E. method of calculating revenue adequacy, only four other roads earned as much as half the cost of capital in 1984, with seven earning less.

While the financial results for 1985 will not be available for several months, it is clear based on the decline in earnings of 22 percent in the first three quarters that the industry will lag considerably behind its performance in 1984. For example, BN's net income from rail operations for the 12 months ending September 30, 1985 was $30 million lower than for the year ending September 30, 1984.

So, even under the method C.U.R.E. would advocate, one searches in vain for evidence of the "extremely high profitability" so apparent to Mr. Cooper.

As to Mr. Mitchell, I think it goes without saying that if his company, PEPCO, had earned less than half its cost of capital for five years running, both he and his investors would be pounding on the doors of the regulatory commission for rate increases.

The Need to Get to the Merits of the Dispute. As I acknowledged at the outset, any advocate can be expected to put the facts of his case forward in their best light. I further acknowledge that the "facts" are not always free of dispute. But if a fact has been determined in a legal proceeding, an assertion of fact at odds with that determination warrants, at the very least, a footnote and an explanation of why the trier of fact was wrong.

I further acknowledge that there are "facts" that ultimately can be determined only by the application of some standard. An example that comes to mind is whether and to what extent the railroads' investment base contains assets that are no longer used and useful. Certainly, the assertion that there are such assets is as supportable as an assertion that there are none. The real issue in this example is the quantity of such assets, the value at which they are being carried on the books, the effect on other shippers of abandoning those assets, and the potential effect of all of those answers on the determination of revenue adequacy.

But the gravamen of the coal and utility interests' assault on Staggers is that captive shippers are being abused by rate actions taken by the railroads. The related argument that the ICC is derelict in its duty to protect them stands or falls on the truth of that proposition because, if the rate actions do not represent an abuse, the ICC has no reason to offer protection. As to the issue of whether there is a pattern of abuse, there are few if any factual subtleties. The rates are a matter of record and the costs have been determined by the ICC or are bounded by the evidence of the parties.

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*/ Since the ICC has not yet issued a decision as to the cost of capital for 1984, the 1984 figures in both instances are AAR's estimates.

Obviously, there can be legitimate arguments as to the correct standard for determining revenue adequacy, market dominance, and the maximum reasonableness of rates, although the weight of economic theory is clearly on the side of the railroads and the ICC as to each. But, on the issue of revising Staggers, those too, are secondary considerations because, first, there should be some showing of injury at the hands of the railroads that requires a redress that has not been granted.*/ Against a mountain of evidence that, in general, there has been no abuse of the captive shipper, there are few more than a handful of complaints pending at the ICC in which some abuse may ultimately be found. Certainly, the mere pendency of these complaints does not call for legislative action.

But, for more than two years now, coal and utility interests have been lobbying with increasing intensity for revision of Staggers. After listening to their arguments, examining their analyses, and checking their facts over that period, in what seems like a hundred forums, I have to conclude that the vehemence of their attack is the only real weapon in their arsenal. Every forum to which they bring their "case" is presented with a "House of Horrors" which is propped up by extravagant claims of injury, all of which collapse as soon as anyone leans against them. This has happened so often that any credibility the coal and utility interests continue to enjoy can only rest on the volume and persistence of their claims--they survive in the simple belief that anyone shouting that loudly and that constantly must be hurting.

I think the time has come to call a halt. The railroads have better places to put their energies and resources than in serving as a "truth squad" attempting to keep up with an unending barrage of some-truths, half-truths, and no-truths. Certainly, the Congress has more pressing business before it.

As I noted in my prepared testimony, the Department of Energy looked at the cases brought to it by EEI and found "no evidence" of abuse, and a study undertaken for the Environmental Protection Agency stated that "...there is little to suggest that deregulation is leading to widespread increases in rail rates above the underlying costs." The ICC's Bureau of Accounts has examined EEI's 19 cases and found the methodology employed to be seriously flawed. After analyzing the C.U.R.E. and CPA studies the Bureau concluded that those studies "do not accurately depict the financial condition of the railroad industry or validate C.U.R.E. and CPA's allegations that the railroads have abused their captive shippers." Professor Keeler, in his analysis of the CPA studies, reaches the same conclusion. And, finally, an eminent group of economists has attested to the basic economic validity of the ICC standards and procedures being attacked by the coal and utility interests.

In short, the coal and utility interests have failed to produce credible evidence of any significant or systematic abuse of captive shippers, either at the hands of the railroads or by virtue of the present or prospective application of ICC standards and procedures. In view of that fact, I would strongly urge that, before your subcommittee conducts hearings on the C.U.R.E. bill, S. 477, C.U.R.E. be required to produce credible evidence of the abuses that might justify the Congress' consideration of such legislation. You might then invite comment on that evidence before convening a hearing. If the evidence put forward by the coal and utility interests at the November oversight hearings is the best they have, we should all turn our attention to pursuits more productive than re-visiting the Staggers Act via the C.UR.E. bill.

Sincerely,

W. H. Dempsey

Enclosures 1/

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*/ For example, it is ludicrous to call for legislative revision of the ICC's procedures for determining revenue adequacy to cure an "abuse" when the industry is no more than half-way toward revenue adequacy under the revised procedures being proposed.

1/ The attachments have been retained in the Committee files.

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[The following information was referred to on p. 55:]

BOND AND EQUIPMENT TRUST CERTIFICATE (ETC) RATINGS OF CLASS I RAILROADS

Railroad	Bond rating	ETC rating
CSX Corp.:		
Baltimore & Ohio	A	Aa
Chesapeake & Ohio	A	Aa
Seaboard System	A	Aa
Norfolk-Southern Corp.:		
Norfolk & Western	Aa	Aaa
Southern Railway	Aa	Aaa
Alabama Great Southern		Aaa
Central of Georgia		
Cinc., New Orleans, Texas Pacific		Aaa
Union Pacific Corp.:		
Union Pacific	Aa	Aaa
Missouri Pacific	A	Aa
Western Pacific	A	
Santa Fe-Southern Pacific:		
Atchison, Topeka & Santa Fe	Aa	Aaa
Southern Pacific	A	Aa
St. Louis—Southwestern	Aa	Aaa
Others with ratings:		
Burlington Northern	Aa	Aaa
Chicago & Northwestern	Ba	A
Illinois Central Gulf	Baa	A
Soo Line	A	Aaa
Missouri-Kansas-Texas	B/Caa	
Boston & Maine	C	

Note: Those railroads not listed above do not have any bond ratings listed in Moody's.
Source: "Moody's Transportation Manual—1985."

[The following information was referred to on p. 56:]

Shipper supplied cars and investment in coal handling facilities are among the recent innovations providing reduced costs to the railroads for handling coal. In addition to these, innovative operating practices such as run-through trains, unit trains, loop track loading and unloading, locomotive pools and guaranteed tenders of traffic volumes have contributed to cost savings particularly in the movement of coal traffic. In return, the railroads have been able to offer reduced rates on this traffic to those shippers able to participate. At this point a look at the ratemaking process may be helpful.

It is a popular misconception that the Commission sets railroad freight rates. On the contrary, the Commission is really the "ratemaker of last resort". Historically, establishing a freight rate has always been the prerogative of railroad management. There are millions of published rates. Most tariff rates which actually move traffic are initially an agreed upon amount determined through negotiation between one or more shippers and one or more railroads (those lines able to participate in the movements). Among the items considered in these negotiations are: the points to be served; minimum tonnage to be tendered by the shipper in a given period of time; type of service to be provided; type of equipment to be used; whether equipment is to be railroad owned or shipper owned; whether shipper is to be reimbursed when providing equipment or an allowance made in the rate; and other specifications affecting the railroad's cost of providing the service.

To fortify themselves in the negotiations, shippers also attempt to estimate the railroad's costs under the various options using publicly available data. Upon agreement, the railroad publishes the rate in a tariff spelling out the requirements which must be met for that rate to apply. Thus, a railroad may publish two rates for a movement between two points, one for the commodity moving in railroad owned cars and a lower rate when the shipper provides the cars. In this manner, cost savings and operational efficiencies under different options are considerations in establishing freight rates which actually move traffic, although cost alone is not the only factor influencing the level of the rate.

In today's regulatory environment, rates established in this manner are virtually unchallenged since they have already been agreed upon by both shipper and railroad. The Commission does not and could not attempt to determine the costs of the thousands of rates filed with it each year. Indeed, it would serve no purpose since most rates are published without controversy. Even when the need arises, the hearing process is the proper arena for determining costs.

Once a rate is established it is subject to upward adjustment to compensate for inflation. Inflationary increases have always been a source of disagreement between the shippers and the railroads. Prior to the Staggers Rail Act of 1980 (Staggers), such increases were complex and lacked any standards in application. This adjustment process has been supplanted by use of the quarterly Rail Cost Adjustment Factor (RCAF) prescribed by Staggers.

The RCAF is an index which measures changes in railroad costs caused solely by inflation. By law, railroads are free to adjust their rates to the level of the RCAF without challenge. It has been in use since June of 1981.

Data on railroad rates indicate that increases taken on all traffic for the past five years generally have been limited to inflationary adjustments or less. There have obviously been some exceptions. However, the principal source of concern among most shippers is not these individual rates but the fact that there is no provision in the law for mandatory downward adjustments when the RCAF decreases. Even here the concern for the most part is expressed by shippers who view themselves as captive. Whereas rates for competitive traffic automatically adjust for changes in cost through the marketplace, non-competitive (captive) traffic will generally not benefit from temporary cost reductions when the RCAF declines.

In the case of individual rate increases beyond those associated with the RCAF, any shipper who believes the level of its rate is unreasonable has the right to file a complaint with the Commission if the movement is captive and the rate exceeds the jurisdictional level. The Commission then determines reasonableness based on cost and other considerations.

In summary, we believe it fair to say that the railroads and shippers both have benefited from improved productivity and economies of density. Moreover, since passage of Staggers rate increases generally have been around inflation levels or less. At the same time the railroads have improved their financial condition. We concede that the captive shipper may make a greater contribution to their financial improvement than the competitive shipper. This should not be viewed as inequitable or unexpected. Competitive traffic is highly sensitive and more easily lost than captive traffic. When competitive traffic is lost, captive traffic will face a greater burden since some costs absorbed by competitive traffic would remain.

Much of the industry was in poor financial condition at the time of Staggers in spite of sizeable rate increases on captive traffic. Thus, improved productivity and reduced costs have permitted the railroads to improve their financial condition with only modest rate increases, benefits favorable to both railroads and shippers.

Questions of Senator Long and the Answers of Mr. Riley

Question. Please address some of the issues that the Federal Railorad Administration said in 1979–1980 were cause for concern and legislation. We in Congress heard much in those days about the 1978 Department of Transportation study that projected a \$13–\$16 billion dollar capital shortfall for the railroads by 1985. It's now 1985. Is there a capital shortfall, or have the major railroads in fact reduced their debt from internally generated sources?

Answer. The major goal of the Staggers Act was to reverse the chronic financial and service weakness of the U.S. freight railroad system, to remove excessive, burdensome, and often counterproductive regulation, and to give the railroads the flexibility and incentive once again to offer safe, adequate, and efficient service to the shipping public. In 1979, the Department of Transportation as well as the railroad industry, shippers, and other levels of government recognized that the railroads faced a severe financial crisis. More than 20 percent of the nation's rail track was being operated under bankruptcy or reorganization. Even the major carriers did not have adequate capital to undertake the maintenance and investment required to accommodate the nation's shipping requirements. Increasing numbers of freight cars and locomotives were out of service for repair, and the equipment fleet was not sufficient to meet demand. Track was deteriorating to the point that, in many parts of the national rail system, trains could only be operated at severely reduced speeds; train accidents and derailments, delays in shipping, and loss and damage to freight plagued rail shippers. Railroads were losing market share to truck competition, and the overall effect was higher operating cost, less capital investment, and less efficient transportation service. Those were the problems the Congress confronted when it formulated the Staggers Act.

The Department's projection of the railroads' capital shortfall was based on a continuation of the effects of regulation. The instruction of the Congress in the Railroad Revitalization and Regulatory Reform Act (4R Act) of 1976 was for DOT to make an estimate of the capital shortfall the Class I railroads (excluding Conrail and Amtrak) would suffer if freight traffic continued to grow as expected, assuming that no changes were made in the rate and other regulatory conditions, operations and structure of the industry. We estimated that, over the ten-year period 1976-1985, the railroads would fall $13-$16 billion short of the capital that would be necessary to support the desired level of rail service. The options were clear: the railroads would either have to forgo a large portion of the projected investment, the Government would have to step in with massive financial assistance, or the underlying regulatory envrionment would have to be radically altered to end the cycle of railroad traffic losses, declining service and physical deterioration.

After that forecast was made, the Congress did adopt significant reforms in the regulatory system, under the Staggers Act. The improvement in the financial condition of the railroad industry since the Staggers Act has been dramatic. Every major railroad is reporting profits. The industry survived the deepest recession since the 1930's without a single bankruptcy. Capital investment has increased, and deferred maintenance has been virtually eliminated on the nation's main lines. With the improved condition of the track, the number of accidents has dropped by two thirds, and the quality and reliability of service have gone up significantly. Traffic is moving without the "car shortages" reported in the 1970's, and shippers no longer face the prospect of the widespread branch line abandonments that were required when capital-starved railroads tried to focus their resources on their highest density track. The railroads now have the ability to adjust rates and to make the kind of marketing and service innovations necessary to be effective competitors.

The railroad industry's return on investment has increased nearly fivefold, from only about 1 percent ten years ago. It was approximately 5 percent last year—a revealing figure because it tells both sides of the story. The 5 percent is certainly a dramatic increase over the previous twenty years, but it is still less than the return an investor could receive by simply depositing money in a savings account. As the nation's utilities have argued so persuasively—and correctly—in their own rate cases, an industry that cannot generate a return on capital equal to the cost of raising that capital is an endangered species. The railroads' rate of return figures emphasize the extent and at the same time the fragility of the industry's recovery. The progress is real, but it can easily be eroded.

It would be extremely difficult to prepare a capital shortfall estimate today that would be precisely comparable to the projected figure developed in 1978. Simulating the shortfall calculation using the data available from railroads' actual reports would produce on overly optimistic comparison, because the railroads' reports are now prepared using depreciation rather than betterment accounting. The railroads have been able to reduce the total amount of outstanding debt by $2.2 billion since the Staggers Act, from $12.8 billion at the end of 1980 to $10.6 billion at the close of 1984. The industry, however, is still in a negative capital position. For the period 1976-1985, the railroads as a group showed retained earnings of nearly $5 billion less than their capital expenditures. Therefore, I cannot represent that the railroad industry has eliminated every dollar of the projected capital gap. It would be fair to say that while the capital shortfall has been diminished, it still exists.

The railroads continue to face substantial capital requirements. Demand for rail service is once again picking up, posing prospects for increasing freight car orders and other capital expenditures. At the same time, maintenance of track and equipment to accommodate rising traffic levels will also require significant expenditures by the railroads. And no corporation or outside investor can be expected to put capital into railroading unless the additional investment represents a potential return comparable to that offered by competing investment opportunities. The railroads cannot continue to provide high quality and competitive service that shippers have come to expect unless they can maintain their financial strength.

To achieve the long-term benefits for shippers, railroads, and the wider public that were intended by the Congress in crafting the Staggers Act, the flexibility and incentives that have been fostered by the legislation must not be treated as one-time boons to the industry, that can be retracted once some of the goals have been achieved. The Congress meant to bring far-reaching, long-term changes in the railroad industry that would permanently relieve the problems shippers and carriers had suffered under the pre-existing regulatory system. It is vital that the gains we have achieved under the Staggers Act not be lost through reimposition of the burdensome, outdated, and unnecessary regulatory constraints prevailing before 1980. Instead, these gains must be consolidated and made a lasting part of our transportation system.

Question. Consumers United For Rail Equity (C.U.R.E.) has prepared a study which shows, according to them, that the railroads today enjoy a $10.5 billion surplus of internally generated funds over capital expenditures. Do you agree? If not, what are the specific points of disagreement?

Answer. The C.U.R.E. analysis is flawed in two ways: the $10.5 billion figure does not accurately reflect actual railroad financial results from 1976 through 1985, and the calculations made to derive that figure do not take into account all of the factors that must be considered in evaluating the capital position of the railroad industry.

The C.U.R.E. figure represents an estimate of the cumulative difference between capital expenditures and retained earnings for Class I railroads (excluding Conrail) from 1976 through 1985. Actual railroad financial reports were used only for 1976 through 1983. C.U.R.E. used a preliminary estimate for the industry for 1984, and assumed that the same figure would apply for 1985. Furthermore, in all cases C.U.R.E. has indicated that its figures are based on betterment accounting, although the railroads were required to shift to depreciation accounting in preparing their full official financial reports beginning with calendar year 1984.

The ICC has attempted to duplicate the C.U.R.E. figures on railroad capital shortfall or surplus. The analysis done by the ICC Bureau of Accounts (submitted to the Subcommittee with the written testimony of ICC Chairman Reese Taylor in connection with this hearing) indicates that C.U.R.E. seriously overstates the railroads' retained earnings and understates their capital expenditures. The C.U.R.E. figures show a surplus of retained earnings over capital expenditures of close to $3.5 billion for 1976–1983, but ICC data show the Class I railroads (excluding Conrail) actually reported retained earnings of nearly $6.0 billion less than capital expenditures for that period. In fact, according to the ICC figures, the railroads (again excluding Conrail) did not generate an excess of retained earnings over capital expenditures in any of those years.

For 1984 and 1985, C.U.R.E. predicted the railroads would experience a surplus of $4 to 5 billion per year. Railroad financial reports to the ICC for those years were prepared using depreciation accounting rather than the "betterment" accounting used until 1983. It is extremely difficult, if not impossible, to develop figures for 1984 and 1985 that reflect what the railroads would have reported using betterment rather than depreciation accounting. Although the ICC continues to require railroads to report a limited number of income statement and balance sheet items on a betterment accounting basis for regulatory purposes, no railroad prepares and it would make little sense to require an entire set of financial statistics, including estimates of what current and deferred tax liabilities or dividend pay-out would have been, under a different accounting system.

However, it is possible to make a crude estimate of what those figures might have been by examining the financial reports under depreciation accounting, and assuming taxes and dividends would have remained the same despite the different accounting system. The ICC made estimates on that basis for 1984 and, following the same approach as C.U.R.E., assumed that 1985 results would match those of 1984. From that analysis, "the ICC concluded that retained earnings would have exceeded capital expenditures in each of the last two years by slightly more than $625 million, bringing the cumulative total difference between retained earnings and capital expenditures for 1976–1985 to a $4.7 billion capital shortfall." We believe the ICC estimates are reasonable. The railroads' investments in capital improvements for roadway and structures—which would be included in the capital expenditure figures under betterment accounting—have generally remained at a high level, while preliminary financial reports for 1985 indicate that railroad earnings will fall somewhat below 1984 levels. In any case, it would not have been possible for the railroads' annual surplus of retained earnings over capital investments in the last two years to have reached the $8 billion level that would have been necessary to bring the combined ten-year total to C.U.R.E.'s estimated surplus of $10.5 billion.

Question. In 1980, was the Burlington Northern facing a capital shortfall? The C&O? The Seaboard? The L&N? The Norfolk & Western? The Southern? Are any of those railroads facing a capital shortfall now? How much, if any, additional funds do they need each year, and from where should those additional funds come?

Answer. The DOT analysis in 1978 did not estimate capital shortfall for individual railroad companies. The figures were disaggregated only to the level of a region—East, South, and West. Then, within the East and West, the railroads that were bankrupt or in extremely marginal financial condition were analyzed separately from all other carriers.

For every region and category, marginal or not, the analysis indicated that the railroads did face a capital shortfall for 1976–1985. For example, the estimated shortfall was $724 million for railroads in the East, excluding Conrail and the other bankrupt or marginal carriers. The Norfolk & Western and the Chessie (the rail system of which the C&O is a large part) were the major railroads covered by that calculation.

The predicted capital shortfall was $2.5 billion for Class I railroads in the South, including Southern Railway, L & N, and Seaboard. The L & N, with the largest volume of Coal among the Sourthern region railroads, was in particularly weak financial condition at that time. L & N reported an actual loss, in terms of net income, of over $20 million in 1978, a working capital deficit for the forth time in five years, inadequate funds to cover even its interest expenses, and massive investment needs for plant and equipment to accommodate dramatically increasing coal traffic. With most of its debt issues rated Baa or Caa, L & N had to take heavy cash advances from its parent, the Seaboard, in order to sustain operations. Seaboard was not among the strongest railroads itself at that time, reporting a rate of return of only 4.5 percent in 1978.

In the West, railroads other than the marginal carriers were projected to face a cumulative capital shortfall of $3.0 billion from 1976 to 1985. The Burlington Northern, the largest coal-carrying railroad in the West, faced many of the same problems as the L & N—sharply rising coal traffic, billions of dollars in rehabilitation and improvement projects necessary to hanlde the traffic, and insufficient rail income to cover fixed charges. The Burlington Northern Railroad had a rate of return on investment of 1.7 percent in 1978. It clearly faced a severe capital shortfall if its fundamental environment did not change.

Again, FRA does not prepare assessments of the investments that individual railroad companies should be making or the level of earnings they should achieve. We do know that the railroads will have to undertake high levels of capital investment to continue to handle traffic economically. We state this in view of the high volumes of coal and other heavy-loading commodities now moving on many parts of the main line rail network and the expected upturn in overall industrial volumes as the economy strengthens.

Question. Are the railroads' revenue needs as critical today as they were in 1980? If not, don't you think it's time the ICC recognized that, and moderated rates on captive shippers who bear this revenue adequacy burden?

Answer. Under the Staggers Act, the railroads' financial strength has improved considerably, and they do not face a capital shortfall of the magnitude estimated in 1978. That was one of the major objectives of the Congress when it passed the legislation. As a group, however, the Class I railroads still have not reached a level of earnings high enough to ensure that the carriers can attract and retain necessary capital.

The ICC continues to review each railroad's annual earnings reports in relation to other financial returns. The recent decision in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines, makes clear that when an individual railroad attains an adequate level of revenues over a sustained period, the Commission will not approve rates on "market dominant" traffic that would contribute to further increases in the railroad's profitability. As long as a railroad is not yet earning adequate revenues in comparison to competing investments, however, the statutory mandate first established in the 4R Act, and strengthened in the Staggers Act, requires the ICC to continue to act in a way that will assist the carrier to achieve that goal.

This does not mean that rates on "market dominant" traffic, even for revenue inadequate carriers, can be set at unreasonable levels. And in fact there is no persuasive evidence that captive shippers are being assessed an inequitable burden. The ICC's rate standards, articulated in its coal rate guidelines, are designed to protect shippers from paying rates that are higher than necessary to cover the costs related to providing the services required. Under those standards, a shipper also cannot be required to cover the costs of facilities it does not need, or to cover the costs of a railroad's inefficiencies in operations, pricing, or management in general. Further, the ICC will require that rate increases otherwise allowable under the guidelines must be phased in gradually if a shipper shows that lower increases would be economically less disruptive and more efficient in the long-term. The Commission adopted all of these protections to increase shippers' ability to moderate rates charged on "market dominant" traffic. The Department of Transportation believes that the Commission's new guidelines are both economically justified and consistent with the intent of the Congress in the Staggers Act. The Commission should be given an opportunity to implement them on a case-by-case basis. If they are implemented judiciously, they will mark an important step in the development of fair and efficient rates for market dominant traffic.

The capital required will have to come from the combination of earnings from operations and other internally generated funds, as well as new debt and equity capital the individual railroads can raise, provided they can demonstrate to potential investors that they have sound, long-term financial prospects.

Question. The Department of Justice says the proposed merger of the Santa Fe and Southern Pacific railroads should not be approved because of its anticompetitive impacts. The Department of Transportation says it should. Isn't it possible that the benefits DOT sees in the merger could be accomplished through less drastic means than wiping out competition in the American Southwest? What about joint rates, through routes, and other competitive access provisions? Don't through routes offer all or most of the efficiencies of a merged railroad?

Answer. The Department has addressed these issues in detail in our formal filings to the ICC on the Southern Pacific-Santa Fe merger. In those statements, we discuss the potential competitive effects and the potential benefits of the proposed transaction, as well as the conditions necessary to prevent reduction in competition. Copies of our filings are attached.

Question. The ICC is required to consider competition in ruling on a railroad merger, but it can nonetheless approve a transaction even if it is anticompetitive. Why shouldn't railroad mergers be treated like any other mergers in this country? What's so different about railroads that they should be shielded from the antitrust laws by ICC review?

Answer. ICC merger standards are not identical to those in the antitrust laws because the railroad industry differs from other industries in important ways. First, railroads provide transportation, an essential service for producers of most goods to get their products to market. Second, unlike most other transportation, railroads have fixed rights-of-way requiring heavy initial investments as well as high operating and maintenance costs. Those costs are borne by the private companies that own and operate the fixed plant. Because of those unique characteristics, the law governing consolidations and similar transactions involving railroads (49 U.S.C. 11344-11346) mandates that the Commission consider a number of factors specific to combinations in the railroad industry. The factors include the effect on the adequacy of transportation to the public, the financial burdens facing the merging parties, and the impacts on competition among rail carriers in the affected region. Based on its experience in regulating the railroads, the ICC has the special expertise necessary to make the determinations required.

The ICC's merger procedures provide a clear, well-established, and equitable system for the Commission to receive the comments of the rail companies involved in a merger, as well as competing carriers, shippers, state and local groups, and other parties interested in the transaction, including the Justice Department. I would also note that provisions similar to those applicable to railroad mergers are contained in the laws governing mergers in the airline industry, which were administered by the Civil Aeronautics Board until 1984 and now are administered by the Department of Transportation.

Question. You testified that the C.U.R.E. legislation would "require" both railroads and shippers to "go back more frequently to the Commission" and would result in the use of "rigid formulas" at the Commission. To what sections of the bill are you referring, and how would those sections have this impact?

Answer. S. 477 would clearly result in railroads and shippers going to the Commission more frequently. The bill would add requirements for new types of proceedings, and it would encourage more proceedings under the existing statutory provisions.

Section 7 of the bill would require the Commission to conduct an annual proceeding to determine not only which rail carriers are earning adequate revenues and which are earning inadequate revenues (as under the present statute), but also how much revenue each revenue inadequate carrier would need in order to achieve revenue adequacy. Beyond examining a railroad's actual revenues, costs, and capital needs, the ICC would have to assess the efficiency of the carrier's overall rates, applying the first two Long-Cannon factors which are now part of an individual maximum rate review under 10707(a)(2)(C) (i) and (ii):

(i) The amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic;

(ii) The amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize revenues from such traffic.

Such calculations require assessments of the revenues and actual costs attributable to individual movements, the market for the commodity involved, and the competitive position of the specific shippers. That is equivalent to a complete investigation of the railroad's entire business and pricing system. The amount of data necessary to conduct such a proceeding would be massive, as well as complex, difficult to assess, and highly sensitive for the railroads and shippers involved. The bill requires the railroads to submit all the information necessary "in a form consistent with and appropriate to the discharge of the Commission's responsibilities." There can be little question that this provision alone will have railroads coming back to the Commission often, and for long periods each year, with a corresponding burden of time, money and other resources.

Section 10 of S. 477 would establish a new requirement for the ICC to call local hearings on an abandonment application, conducted at the railroad's expense, on request of protestants located in any community affected by the abandonment. This would also mean more hearings in which shippers and railroads would be participating.

Other sections of the proposed legislation would have a similar effect. Section 3 would artificially restrict the situations in which the ICC could consider the existence of product and geographic competition in making a market dominance determination, by forbidding the Commission to examine product and geographic competition with respect to an origin. The bill would thereby encourage more shippers to bring rate cases to the ICC, even though product and geographic competition may effectively constrain the freight rates that they pay.

Section 6 of the proposed bill would require every tariff rate that had been increased by the Rail Cost Adjustment Factor when railroads' costs went up to be reduced if railroads' costs went down. The bill recognizes that the railroads are by law granted the flexibility to raise individual rates beyond the level of cost increases; the Commission does not have the legal authority to prescribe a rate reduction unless a rate is above a maximum reasonable level. Under the C.U.R.E. proposal, even if a rate has not gone up by more than the zone of rate flexibility or is otherwise not above a reasonable level, a railroad would be required to reduce an existing tariff to correspond to a lower Rail Cost Adjustment Factor, and then subsequently to propose an independent rate action if it chose to maintain the present rate level. As a result, railroads would have to come back to the ICC far more often with rate proposals, even where the rate action is not reviewable by the Commission. Part of the purpose of the inflation-based rate provisions in the Staggers Act, along with the zone of rate flexibility, was to reduce the volume and complexity of tariff filings and minimize the procedural difficulties and administrative burden involved in implementing rate adjustments that are at or near the level of changes in costs. The C.U.R.E. provision thwarts that purpose, by increasing the number of tariff actions required, without necessarily producing any change in rates charged to shippers.

In my testimony, I emphasized that the C.U.R.E. proposal would not only lead to more Commission proceedings but would also require more ICC findings based on rigid formulas. For example, under Section 9 of the bill, in the area of joint rates, C.U.R.E. proposes that the present law be amended to require railroads to reinstate or maintain "competitive" joint or proportional rates via a particular interchange point, upon request of a connecting carrier at the point, a shipper or receiver. The definition of the term "competitive" in that provision is indicated by the proposed language that such "rate shall be conclusively deemed competitive" if the revenue-to-variable cost ratio represented by the rate is no higher than the revenue-to-variable cost ratio for the carrier's competing single-line rate or an existing joint rate between the same origin and destination. This would extend the range of cases that could be brought before the ICC, encourage ratemaking based on formulas such as revenue-to-variable cost ratios, or force railroads and shippers into protracted litigation over the economically justified interpretation of the key word "competitive."

Finally, C.U.R.E.'s proposed changes to the maximum rate reasonableness provisions, under Section 4 of S. 477, would make it extremely difficult to justify rates above the jurisdictional threshold. Furthermore, the proposal would forbid the ICC from applying its market-based standards for evaluating rates, thus pushing the Commission back to the kind of cost tests and other formulas that have already been proven inadequate and inappropriate for the complicated task of determining what are efficient and compensatory prices for rail services.

In the Staggers Act, the Congress recognized that if railroads were constrained to set rates according to a rate-to-cost standard or other rigid limit, they would not be able to earn adequate revenues. The Staggers Act, as well as decisions of the ICC and the courts both before and after the law was passed, explicitly permit "differential pricing" as the only way a carrier can be assured of the possibility of attaining the revenue adequacy goal. The Staggers Act dictated that, after October 1, 1984, any rail rate below the threshold value of 180 percent of variable cost (or the percentage established by the Commission under 49 U.S.C. 10709(d)(1)(B), constrained to be between 170 and 180 percent) would be per se reasonable, and above that level, railroads would be free to establish rates, subject to regulation under 49 U.S.C. 10701a et seq.

Section 4 of the C.U.R.E. bill would work to turn the floor on Commission jurisdiction over maximum rates into a rate ceiling. It would create a substantially greater evidentiary burden to prove that a rate above the threshold was justified. In each rate case, even for a railroad already determined to be revenue inadequate under the stringent standards of the C.U.R.E. bill, the ICC would be required to make findings on the need of the rail carrier to have the opportunity to achieve revenue adequacy, and whether and to what extent such need requires allowing the rail carrier to charge rates exceeding the jurisdictional threshold. This requirement suggests that—beyond an exhaustive annual evaluation of the present revenue shortfall of a railroad as well as the efficiency of its pricing, as required under Section 7 of the bill—the Commission would have to conduct a separate examination of whether it would be necessary for the carrier to be able to achieve revenue adequacy and the extent to which it should be entitled to use the differential pricing flexibility granted under the Staggers Act. To satisfy the strictures of Section 7, the ICC would apparently have to consider not only the relationship of rates to costs and revenue-to-cost formulas, but also potentially the complex question of the equity of allowing a particular shipper to be charged a rate above a threshold value.

Question. You also said that the C.U.R.E. legislation would create "regulatory lag" of a billion dollars a year or more. To what sections of the bill are you referring, and how would those sections have this impact? Does the C.U.R.E. legislation alter the law or regulations respecting suspensions?

Answer. I noted in my testimony that before the Staggers Act, the industry lost about a billion dollars a year due to regulatory lag. That figure was drawn from the findings of a number of government and private studies on the costs of regulation, summarized in House Report No. 96-1035 (May 16, 1980) on the Rail Act of 1980 (H.R. 7235). The C.U.R.E. proposal would delay the railroads from recouping their full costs, by increasing the regulatory burden involved in adjusting rates and services, blocking necessary and prudent inflation-based increases, and discouraging independent rate actions even where they are justified by costs.

As noted in response to the preceding question, the C.U.R.E. bill would increase the number of rate actions likely to be subject to ICC review and would make it more costly, difficult and time-consuming for a railroad to justify a rate change. The net effect would be to discourage railroads from proposing independent rate actions, even when needed to cover their costs; it would foster increased reliance on generalized, across-the-board increases based on estimates of industrywide inflation. Further compounding the problem, Section 6 of S. 477 would lead to understating the inflation incurred by the railroads, thus reducing the proportion of cost increases they could recoup through the allowable inflation-based rate increases. The inevitable result would be that railraods would fall behind in covering costs, due to the loss of both the ability and incentive to make timely adjustments to their rates.

In the area of joint rates, the C.U.R.E. proposal would not only encourage more cases and impose much greater restrictions on railroad flexibility, it would also open up the possibility that joint rate actions implemented by the railroads in the past five years could be revoked. The Congress recognized in formulating the Staggers Act that the ability to adjust joint rates and routes was essential if the railroads were to redress historic inequities and inefficiencies in their rate structure and recover from their financial and economic crisis. The rigidity of the joint rates system, the long and difficult regulatory proceedings involved in seeking changes, and the frequent disapproval of proposed adjustments were a key factor in the collapse of the Northeast rail system and the continuing weakness of many of the nation's carriers. Despite a numnber of rail mergers since 1980 and increasing emphasis on longer single-line movements, joint-line service still makes up a substantial proportion of the traffic base for many railroads. Losing the flexibility to set rates to reflect volume and overall efficiency and to generate a reasonable division of the revenues on joint-line traffic would again jeopardize the viability of those carriers and the efficiency and stability of the entire system.

The C.U.R.E. proposal also would pose the threat of costly delays in the area of abandonments of rail lines and services. The Congress, the ICC, and many shippers have recognized that a railroad must be able to make changes in its plant and services, as well as in its rates, in order to adjust to market conditions, reduce inefficiencies, and remain financially viable for the long term. Section 10 of S. 477, however, would prolong abandonment cases at the ICC and impose additional procedural burdens on the carriers proposing abandonments, by requiring local hearings, and by stretching out the timetable for commission review. While more of these would likely alter the outcome of a proceeding, they would force delays and needless additional costs on all parties. Such provisions, like the others mentioned above, would work to increase costs to the carriers, hold up or deter altogether proposed actions even if they meet statutory criteria for ICC approval, and inhibit achievement of the goals of shippers and the Congress in the Staggers Act of encouraging efficiency and assisting railroads to eliminate operations that are not compensatory.

Section 11 of S. 477, governing state jurisdiction over intrastate rail rates and other practices, could also act to delay or even block entirely timely adjustments in intrastate rail rates and services, even if they were fully justified under Staggers Act standards. It would remove the ICC's authority under the Staggers Act to preempt a state regulatory body's jurisdiction over intrastate rates and services if decisions at the state level are not consistent with Federal law and policy. Instead, under the C.U.R.E. proposal, the Commission would be limited to reviewing individual cases decided by a state, and vacating and remanding individual decisions not in compliance with the statutory requirements. Thus, although a state would by law still be required to follow the same standards set down for the Commission under the Staggers Act, the state could in fact continue to deny specific rate and service proposals, in contradiction of all national rail policies. The state's decisions thereby could effectively suspend application of a carrier's intrastate rate changes, abandonments, and other actions, pending review by the ICC. Delays imposed by state regulations played a part in the railroads' difficulties before 1980 and could clearly contribute to burdensome regulatory lag.

Under the regulatory system prevailing in the mid-1970's, the simple possibility of having to defend a rate against challenge at the ICC was not the only factor that kept railroads from making rate adjustments, even for interstate rates. The threat of rate suspension, a great deterrent, was reduced considerably by both the 4R Act and the Staggers Act. The C.U.R.E. bill does not alter the actual suspension provisions in the statute, as they relate to rate changes. The bill could increase the likelihood of suspension, however, by restricting the scope of the evidence a shipper would have to present in order to prevail in cases concerning joint rates and rate reasonableness in general. Those changes would affect the suspension process, because the first requirement for obtaining a suspension is that the shipper prove it is substantially likely to prevail on the merits of the case (4 U.S.C. 10707(c)(1)(A)).

The C.U.R.E. proposal would alter the statutory provisions concerning suspension of cancellations of reciprocal switching arrangements. In that area, Section 7(b)(2) of S. 477 would require the ICC to suspend a cancellation if it determined that a shipper had utilized or would utilize the switching service for a significant portion of its rail needs at the facility involved. As experience has demonstrated with other suspension authority in the past, that provision would be likely to reduce railroads' ability to adjust charges and to recover the full costs of the services they provide under switching arrangements.

Finally, we should not overlook the serious effect of "regulatory lag" on shippers as well as railroads due to the absence of supportable regulatory standards that can be applied when a case is brought to the ICC. In the rate area in particular, the ICC has recently adopted guidelines that it can use to resolve the majority of the rate cases still pending. Many of those cases were filed in early 1981 under Section 229 of the Staggers Act; others remain in abeyance, from before 1980. Shippers and railroads have operated in the intervening years without any certainty as to what type of stndards the ICC would apply, when a case would be closed or whether a final decision would ever be reached.

Many shippers have sacrificed time and money to prepare evidence two or three times, as the Commission's successive sets of standards were overturned by the courts and it tried yet another proposal. Surely that is one of the most frustrating shortcomings of the regulatory system since 1980. Now, after eight years of struggle to develop a set of rate standards that would be consistent with the law and also economically justified, the new guidelines appear to satisfy legal and economic principles. Together, the elements of "constrained market pricing" represent the only defensible means, among all the proposals advanced, for balancing shippers' need for protection from unreasonable rates with railroads' need to earn adequate revenues. Yet Section 4 of the C.U.R.E. proposal would forbid use of a stand-alone cost test, a critical element in those guidelines, without offering any substitute.

To enact such a provision would throw the ICC back to the beginning of the search for reasonable rate standards—back into evidentiary proceedings, court challenge, and further delays. Once again, resolution of long-awaited rate decisions would be held up while the litigation went on to find a substitute for the present standard, under the general but proscriptive language of the C.U.R.E. bill. That would be a destructive, not a constructive, change. After the experiences of the last six years and more, neither railroads nor shippers could welcome that form of regulatory lag.

As part of the corrected transcript of the November 1 hearing which the Administrator provided to the Committee, we have already submitted responses to very similar questions from Senator Pressler concerning how to go about preserving service on the light-density lines in South Dakota—particularly the Rapid City-Pierre and Aberdeen-Oakes lines. (See attached copy of insert for the record.)

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